

KAR Auction Services, Inc.
Form 10-Q
August 07, 2012

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

ý **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2012

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission File Number: 001-34568

KAR Auction Services, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

20-8744739
(I.R.S. Employer
Identification No.)

13085 Hamilton Crossing Boulevard
Carmel, Indiana 46032
(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(800) 923-3725**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a
smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of July 31, 2012, 136,467,589 shares of the registrant's common stock, par value \$0.01 per share, were outstanding.

Table of Contents

KAR Auction Services, Inc.
Table of Contents

	Page
<u>PART I FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements (Unaudited)</u>	
<u>Consolidated Statements of Operations</u>	<u>3</u>
<u>Consolidated Statements of Comprehensive Income (Loss)</u>	<u>4</u>
<u>Consolidated Balance Sheets</u>	<u>5</u>
<u>Consolidated Statement of Stockholders' Equity</u>	<u>7</u>
<u>Consolidated Statements of Cash Flows</u>	<u>8</u>
<u>Notes to Consolidated Financial Statements</u>	<u>9</u>
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>38</u>
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>59</u>
<u>Item 4.</u>	
<u>Controls and Procedures</u>	<u>59</u>
<u>PART II OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	<u>60</u>
<u>Item 1A.</u>	
<u>Risk Factors</u>	<u>61</u>
<u>Item 4.</u>	
<u>Mine Safety Disclosures</u>	<u>61</u>
<u>Item 6.</u>	
<u>Exhibits</u>	<u>61</u>
<u>Signatures</u>	<u>62</u>

Exhibit Index

2

63

Table of Contents

PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

KAR Auction Services, Inc.

Consolidated Statements of Operations

(In millions, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Operating revenues				
ADESA Auction Services	\$ 263.8	\$ 257.5	\$ 534.4	\$ 525.8
IAA Salvage Services	177.3	173.2	366.7	349.1
AFC	46.8	42.0	93.7	82.5
Total operating revenues	487.9	472.7	994.8	957.4
Operating expenses				
Cost of services (exclusive of depreciation and amortization)	263.2	254.4	532.6	518.9
Selling, general and administrative	103.5	99.4	217.6	202.1
Depreciation and amortization	48.0	43.6	96.6	87.7
Total operating expenses	414.7	397.4	846.8	808.7
Operating profit	73.2	75.3	148.0	148.7
Interest expense	29.6	49.7	59.9	82.9
Other (income) expense, net	(0.5)	(6.7)	(0.4)	(7.3)
Loss on extinguishment of debt	0	53.5	0	53.5
Income (loss) before income taxes	44.1	(21.2)	88.5	19.6
Income taxes	20.2	(6.9)	38.6	(5.9)
Net income (loss)	\$ 23.9	\$ (14.3)	\$ 49.9	\$ 25.5
Net income (loss) per share				
Basic	\$ 0.18	\$ (0.11)	\$ 0.37	\$ 0.19
Diluted	\$ 0.17	\$ (0.11)	\$ 0.36	\$ 0.19

See accompanying notes to consolidated financial statements

Table of Contents**KAR Auction Services, Inc.****Consolidated Statements of Comprehensive Income (Loss)****(In millions)****(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income (loss)	\$ 23.9	\$ (14.3)	\$ 49.9	\$ 25.5
Other comprehensive income (loss), net of tax				
Foreign currency translation gain (loss)	(4.7)	2.0	1.1	10.1
Unrealized gain (loss) on interest rate derivatives, net of tax of \$0 and \$0.2 for the three months ended June 30, 2012 and 2011, and \$0.2 and \$0.9 for the six months ended June 30, 2012 and 2011	0	(0.1)	(0.4)	1.5
Early termination of swap agreement, net of tax of \$5.5 for the three and six months ended June 30, 2011	0	9.0	0	9.0
Total other comprehensive income (loss), net of tax	(4.7)	10.9	0.7	20.6
Comprehensive income (loss)	\$ 19.2	\$ (3.4)	\$ 50.6	\$ 46.1

See accompanying notes to consolidated financial statements

Table of Contents**KAR Auction Services, Inc.****Consolidated Balance Sheets****(In millions)****(Unaudited)**

	June 30, 2012	December 31, 2011
Assets		
<i>Current assets</i>		
Cash and cash equivalents	\$ 117.1	\$ 97.4
Restricted cash	9.3	8.2
Trade receivables, net of allowances of \$6.6 and \$6.4	358.4	297.4
Finance receivables, net of allowances of \$9.0 and \$9.0	926.5	874.2
Deferred income tax assets	37.5	37.5
Other current assets	66.1	58.5
Total current assets	1,514.9	1,373.2
<i>Other assets</i>		
Goodwill	1,679.5	1,679.5
Customer relationships, net of accumulated amortization of \$362.2 and \$325.8	658.3	694.0
Other intangible assets, net of accumulated amortization of \$155.5 and \$139.5	297.2	305.9
Unamortized debt issuance costs	25.1	28.6
Other assets	9.4	11.2
Total other assets	2,669.5	2,719.2
Property and equipment, net of accumulated depreciation of \$390.8 and \$362.4	684.2	686.7
Total assets	\$ 4,868.6	\$ 4,779.1

See accompanying notes to consolidated financial statements

Table of Contents**KAR Auction Services, Inc.****Consolidated Balance Sheets (Continued)****(In millions, except share and per share data)****(Unaudited)**

	June 30, 2012	December 31, 2011
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 452.7	\$ 367.8
Accrued employee benefits and compensation expenses	52.5	57.7
Accrued interest	2.3	2.3
Other accrued expenses	67.6	71.7
Income taxes payable	13.8	0.5
Obligations collateralized by finance receivables	634.1	610.3
Current maturities of long-term debt	17.0	85.9
Total current liabilities	1,240.0	1,196.2
Non-current liabilities		
Long-term debt	1,809.1	1,816.9
Deferred income tax liabilities	311.5	323.9
Other liabilities	99.7	98.9
Total non-current liabilities	2,220.3	2,239.7
Commitments and contingencies (Note 8)		
Stockholders' equity		
Preferred stock, \$0.01 par value:		
Authorized shares: 100,000,000		
Issued shares: none	0	0
Common stock, \$0.01 par value:		
Authorized shares: 400,000,000		
Issued and outstanding shares:		
June 30, 2012: 136,429,099		
December 31, 2011: 136,271,358	1.4	1.4
Additional paid-in capital	1,420.9	1,406.4
Accumulated deficit	(42.8)	(92.7)
Accumulated other comprehensive income	28.8	28.1
Total stockholders' equity	1,408.3	1,343.2
Total liabilities and stockholders' equity	\$ 4,868.6	\$ 4,779.1

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Consolidated Statement of Stockholders' Equity

(In millions)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2011	136.3	\$ 1.4	\$ 1,406.4	\$ (92.7)	\$ 28.1	\$ 1,343.2
Net income				49.9		49.9
Other comprehensive income, net of tax					0.7	0.7
Issuance of common stock under stock plans	0.1		1.2			1.2
Stock-based compensation expense			13.3			13.3
Balance at June 30, 2012	136.4	\$ 1.4	\$ 1,420.9	\$ (42.8)	\$ 28.8	\$ 1,408.3

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2012	2011
Operating activities		
Net income	\$ 49.9	\$ 25.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	96.6	87.7
Provision for credit losses	6.0	3.5
Deferred income taxes	(12.3)	(4.9)
Amortization of debt issuance costs	3.5	6.3
Stock-based compensation	13.3	19.2
Contingent consideration adjustment	1.0	(5.9)
Gain on disposal of fixed assets	(0.1)	(0.1)
Loss on extinguishment of debt	0	53.5
Other non-cash, net	3.1	4.1
Changes in operating assets and liabilities, net of acquisitions:		
Trade receivables and other assets	(70.5)	(63.8)
Accounts payable and accrued expenses	79.8	32.4
Net cash provided by operating activities	170.3	157.5
Investing activities		
Net increase in finance receivables held for investment	(56.3)	(18.4)
Acquisition of businesses, net of cash acquired	(0.5)	(4.2)
Purchases of property, equipment and computer software	(37.3)	(39.3)
Proceeds from the sale of property and equipment	0.1	0
(Increase) decrease in restricted cash	(1.1)	1.8
Net cash used by investing activities	(95.1)	(60.1)
Financing activities		
Net increase in book overdrafts	7.8	49.5
Net decrease in borrowings from lines of credit	(68.9)	0
Net increase in obligations collateralized by finance receivables	23.8	16.3
Proceeds from long-term debt	0	1,691.5
Payments for debt issuance costs	0	(30.4)
Payments on long-term debt	(8.5)	(1,144.6)
Payment for early extinguishment of debt	0	(600.7)
Payments on capital leases	(6.8)	(2.3)
Payments of contingent consideration and deferred acquisition costs	(3.7)	(2.3)
Issuance of common stock under stock plans	1.2	5.5
Net cash used by financing activities	(55.1)	(17.5)
Effect of exchange rate changes on cash	(0.4)	1.3
Net increase in cash and cash equivalents	19.7	81.2
Cash and cash equivalents at beginning of period	97.4	119.1
Cash and cash equivalents at end of period	\$ 117.1	\$ 200.3

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Cash paid for interest	\$	54.2	\$	82.8
Cash paid for taxes, net of refunds	\$	36.9	\$	22.7

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements

June 30, 2012 (Unaudited)

Note 1 Basis of Presentation and Nature of Operations

Defined Terms

Unless otherwise indicated, the following terms used herein shall have the following meanings:

"we," "us," "our," "KAR Auction Services" and "the Company" refer, collectively, to KAR Auction Services, Inc. and all of its subsidiaries unless the context otherwise requires;

"ADESA" refers, collectively, to ADESA, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries, including OPENLANE, Inc. ("OPENLANE", a wholly owned subsidiary of ADESA and its subsidiaries);

"AFC" refers, collectively, to Automotive Finance Corporation, a wholly owned subsidiary of ADESA and its related subsidiaries;

"Axle LLC" refers to Axle Holdings II, LLC, which is owned by affiliates of certain of the Equity Sponsors (Kelso & Company and Parthenon), certain members or former members of IAA management and certain co-investors in connection with the acquisition of IAA in 2005. Axle LLC is the former ultimate parent company of IAA and is a holder of common equity interests in KAR LLC;

"Credit Agreement" refers to the Credit Agreement, dated May 19, 2011, among KAR Auction Services, as the borrower, the several banks and other financial institutions or entities from time to time parties thereto and the administrative agent;

"Credit Facility" refers to the \$1.7 billion, six-year senior secured term loan facility and the \$250 million, five-year senior secured revolving credit facility, the terms of which are set forth in the Credit Agreement;

"Equity Sponsors" refers, collectively, to Kelso Investment Associates VII, L.P., GS Capital Partners VI, L.P., ValueAct Capital Master Fund, L.P. and Parthenon Investors II, L.P., which collectively own through their respective affiliates a majority of the equity of KAR Auction Services;

"IAA" refers, collectively, to Insurance Auto Auctions, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries; and

"KAR LLC" refers to KAR Holdings II, LLC, which is owned by affiliates of the Equity Sponsors and management of the Company, and owns a majority of our common stock.

Basis of Presentation

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, or U.S. GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for annual financial statements. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole. In the opinion of management, the consolidated financial statements reflect all adjustments necessary, generally consisting of normal recurring accruals, for a fair statement of our financial results for the periods

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2012 (Unaudited)

Note 1 Basis of Presentation and Nature of Operations (Continued)

presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates.

These consolidated financial statements and condensed notes to consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011. The 2011 year-end consolidated balance sheet data included in this Form 10-Q was derived from the audited financial statements referenced above, but does not include all disclosures required by U.S. GAAP for annual financial statements.

Reclassifications and Revisions

Certain prior year amounts in the consolidated financial statements have been reclassified or revised to conform to the current year presentation. As previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, in the past, certain AFC fees collected from customers were netted against cost of services as well as certain selling, general and administrative expenses. For the three and six months ended June 30, 2011, AFC's revenue, cost of services and selling, general and administrative expenses have been revised, resulting in an increase in revenue as well as the related expenses, with no impact on net income.

Business and Nature of Operations

As of June 30, 2012, we have a network of online whole car auctions, 68 ADESA whole car auction sites and 161 IAA salvage vehicle auction sites. Our auctions facilitate the sale of used and salvage vehicles through physical, online or hybrid auctions, which permit internet buyers to participate in physical auctions. ADESA Auctions and IAA are leading, national providers of wholesale and salvage vehicle auctions and related vehicle remarketing services for the automotive industry in North America. Our online service offerings include OPENLANE, a leader in internet-based remarketing solutions, and allow us to offer vehicles for sale from any location. Remarketing services include a variety of activities designed to transfer used and salvage vehicles between sellers and buyers throughout the vehicle life cycle. ADESA Auctions and IAA facilitate the exchange of these vehicles through an auction marketplace, which aligns sellers and buyers. As an agent for customers, the Company generally does not take title to or ownership to vehicles sold at the auctions. Generally fees are earned from the seller and buyer on each successful auction transaction in addition to fees earned for ancillary services.

ADESA has the second largest used vehicle auction network in North America, based upon the number of used vehicles sold through auctions annually, and also provides services such as inbound and outbound transportation logistics, reconditioning, vehicle inspection and certification, titling, administrative and salvage recovery services. ADESA is able to serve the diverse and multi-faceted needs of its customers through the wide range of services offered.

IAA is one of the two largest providers of salvage vehicle auctions and related services in North America. The salvage auctions facilitate the remarketing of damaged vehicles that are designated as

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2012 (Unaudited)

Note 1 Basis of Presentation and Nature of Operations (Continued)

total losses by insurance companies, recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made and older model vehicles donated to charity or sold by dealers in salvage auctions. The salvage auction business specializes in providing services such as inbound and outbound transportation logistics, inspections, evaluations, salvage recovery services, titling and settlement administrative services.

AFC is a leading provider of floorplan financing to independent used vehicle dealers and this financing was provided through 104 locations throughout North America at June 30, 2012. Floorplan financing supports independent used vehicle dealers in North America who purchase vehicles at ADESA, IAA, independent auctions and auctions affiliated with other auction networks.

Note 2 Acquisitions

Some of our acquisitions from prior years include contingent payments related to revenues or unit volumes of certain vehicles sold subsequent to the purchase dates. In the first six months of 2012, we recorded contingent consideration of approximately \$1.0 million related to certain prior year acquisitions based on revised forecasts which indicated the unit volumes required during the measurement period in order for the contingent consideration to become payable would be met. In the second quarter of 2011, we reversed contingent consideration of approximately \$5.9 million. The contingent consideration adjustments were recorded to "Other (income) expense, net" in the consolidated statements of operations.

Note 3 Stock-Based Compensation Plans

We adopted the KAR Auction Services, Inc. 2009 Omnibus and Stock Incentive Plan ("Omnibus Plan") in December 2009. The Omnibus Plan is intended to provide equity or cash based awards to our employees. On February 29, 2012, we granted approximately 0.5 million service options with an exercise price of \$16.07 per share under the Omnibus Plan, and on May 9, 2012, we granted approximately 0.2 million service options with an exercise price of \$16.51 per share under the Omnibus Plan. The service options have a ten year life and vest in four equal annual installments, commencing on the first anniversary of the grant date. The fair value of the service options granted on February 29 and May 9, 2012 was \$4.91 and \$5.02, respectively. The fair value was estimated on the dates of grant using the Black-Scholes option pricing model with an expected life of 4 years, an expected volatility of 38% and a risk free interest rate of 0.65% for February 29, 2012 and 0.565% for May 9, 2012.

Our stock-based compensation expense includes expense associated with KAR Auction Services, Inc. service and exit option awards, KAR LLC profit interests and Axle LLC profit interests. We have classified the KAR LLC and Axle LLC profit interests as liability awards. We have classified the KAR Auction Services, Inc. service and exit options as equity awards. The main difference between a liability-classified award and an equity-classified award is that liability-classified awards are

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 3 Stock-Based Compensation Plans (Continued)**

remeasured each reporting period at fair value. The following table summarizes our stock-based compensation expense by type of award (*in millions*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Service options	\$ 0.7	\$ 0.3	\$ 1.2	\$ 0.4
Exit options	2.5	4.1	5.1	8.4
KAR LLC profit interests	1.0	4.0	3.7	5.9
Axle LLC profit interests	0.8	3.1	3.3	4.5
Total	\$ 5.0	\$ 11.5	\$ 13.3	\$ 19.2

There is no income tax benefit associated with the KAR LLC and Axle LLC profit interests. The total income tax benefit recognized in the consolidated statement of operations for options was approximately \$1.1 million and \$1.5 million for the three months ended June 30, 2012 and 2011, respectively, and \$2.2 million and \$3.1 million for the six months ended June 30, 2012 and 2011, respectively.

Note 4 Net Income (Loss) Per Share

The following table sets forth the computation of net income (loss) per share (*in millions except per share amounts*):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income (loss)	\$ 23.9	\$ (14.3)	\$ 49.9	\$ 25.5
Weighted average common shares outstanding	136.4	136.0	136.3	135.8
Effect of dilutive stock options	2.5	0	2.4	1.8
Weighted average common shares outstanding and potential common shares	138.9	136.0	138.7	137.6
Net income (loss) per share				
Basic	\$ 0.18	\$ (0.11)	\$ 0.37	\$ 0.19
Diluted	\$ 0.17	\$ (0.11)	\$ 0.36	\$ 0.19

Basic net income (loss) per share was calculated by dividing net income (loss) by the weighted-average number of outstanding common shares for the period. Diluted net income (loss) per share was calculated consistent with basic net income (loss) per share including the effect of dilutive unissued common shares related to our stock-based employee compensation program. The effect of stock options on net income (loss) per share-diluted is determined through the application of the treasury stock method, whereby proceeds received by the Company based on assumed exercises are hypothetically used to repurchase our common stock at the average market price during the period. Stock options that would have an anti-dilutive effect on net income per share are excluded from the

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 4 Net Income (Loss) Per Share (Continued)**

calculations. Approximately 0.9 million options were excluded from the calculation of diluted net income per share for the three months ended June 30, 2012, and approximately 1.6 million and 0.7 million options were excluded from the calculation of diluted net income per share for the six months ended June 30, 2012 and 2011, respectively. Total options outstanding at June 30, 2012 and 2011 were 9.9 million and 9.0 million, respectively. In accordance with U.S. GAAP, no potential common shares were included in the computation of diluted net loss per share for the three months ended June 30, 2011 because to do so would have been anti-dilutive based on the quarter-to-date loss.

Note 5 Finance Receivables and Obligations Collateralized by Finance Receivables

AFC sells the majority of its U.S. dollar denominated finance receivables on a revolving basis and without recourse to a wholly owned, bankruptcy remote, consolidated, special purpose subsidiary ("AFC Funding Corporation"), established for the purpose of purchasing AFC's finance receivables. A securitization agreement allows for the revolving sale by AFC Funding Corporation to a bank conduit facility of undivided interests in certain eligible finance receivables subject to committed liquidity. The agreement expires on June 30, 2014. AFC Funding Corporation had committed liquidity of \$650 million for U.S. finance receivables at June 30, 2012.

We also have an agreement for the securitization of Automotive Finance Canada, Inc.'s ("AFCI") receivables. This securitization facility expires on June 30, 2014. AFCI's committed liquidity is provided through a third party conduit (separate from the U.S. conduit) and was C\$100 million at June 30, 2012. The receivables sold pursuant to both the U.S. and Canadian securitization agreements are accounted for as secured borrowings.

The following tables present quantitative information about delinquencies, credit losses less recoveries ("net credit losses") and components of securitized financial assets and other related assets managed. For purposes of this illustration, delinquent receivables are defined as receivables 31 days or more past due.

June 30, 2012

(in millions)	Principal Amount of:		Net Credit Losses	Net Credit Losses
	Receivables	Receivables Delinquent	Three Months Ended June 30, 2012	Six Months Ended June 30, 2012
Floorplan receivables	\$ 929.9	\$ 1.7	\$ 1.6	\$ 4.5
Special purpose loans	5.6	0.2	0	0
Total receivables managed	\$ 935.5	\$ 1.9	\$ 1.6	\$ 4.5

December 31, 2011

(in millions)	Principal Amount of:		Net Credit Losses	Net Credit Losses
	Receivables	Receivables Delinquent	Three Months Ended June 30, 2011	Six Months Ended June 30, 2011
Floorplan receivables	\$ 877.6	\$ 3.3	\$ 0.8	\$ 3.5
Special purpose loans	5.6	0.3	0	0
Total receivables managed	\$ 883.2	\$ 3.6	\$ 0.8	\$ 3.5

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 5 Finance Receivables and Obligations Collateralized by Finance Receivables (Continued)**

AFC's allowance for losses was \$9.0 million at June 30, 2012 and December 31, 2011.

As of June 30, 2012 and December 31, 2011, \$928.1 million and \$877.6 million, respectively, of finance receivables and a cash reserve of 1 percent of the obligations collateralized by finance receivables served as security for the \$634.1 million and \$610.3 million of obligations collateralized by finance receivables at June 30, 2012 and December 31, 2011, respectively. The amount of the cash reserve depends on circumstances which are set forth in the securitization agreements.

Proceeds from the revolving sale of receivables to the bank conduit facility are used to fund new loans to customers. AFC, AFC Funding Corporation and AFCI must maintain certain financial covenants including, among others, limits on the amount of debt AFC and AFCI can incur, minimum levels of tangible net worth, and other covenants tied to the performance of the finance receivables portfolio. The securitization agreements also incorporate the financial covenants of our Credit Facility. At June 30, 2012, we were in compliance with the covenants in the securitization agreements.

Note 6 Long-Term Debt

Long-term debt consisted of the following (*in millions*):

	Interest Rate	Maturity	June 30, 2012	December 31, 2011
Term Loan B	Adjusted LIBOR + 3.75%	May 18, 2017	\$ 1,683.0	\$ 1,691.5
\$250 million revolving credit facility	Adjusted LIBOR + 3.50%	May 18, 2016	0	68.9
Floating rate senior notes	LIBOR + 4.00%	May 01, 2014	150.0	150.0
Canadian line of credit	CAD Prime + 1.5%	Repayable upon demand	0	0
Total debt			1,833.0	1,910.4
Unamortized debt discount			(6.9)	(7.6)
Current portion of long-term debt			(17.0)	(85.9)
Long-term debt			\$ 1,809.1	\$ 1,816.9

Credit Facilities

On May 19, 2011, we established a \$1.7 billion, six-year senior secured term loan facility (Term Loan B in the table above) and a \$250 million, five-year senior secured revolving credit facility (\$250 million revolving credit facility in the table above), the terms of which are set forth in the Credit Agreement dated as of May 19, 2011. The Credit Facility is available for letters of credit, working capital and general corporate purposes (including refinancing certain Existing Indebtedness (as defined in the Credit Agreement)). The Company pays a commitment fee of 50 basis points, payable quarterly, on the average daily unused amount of the Credit Facility. The interest rate on Term Loan B was 5.0% at June 30, 2012.

There were no borrowings on the revolving credit facility at June 30, 2012, and at December 31, 2011, \$68.9 million was drawn. In addition, we had related outstanding letters of credit in the aggregate

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2012 (Unaudited)

Note 6 Long-Term Debt (Continued)

amount of \$23.8 million and \$28.5 million at June 30, 2012 and December 31, 2011, respectively, which reduce the amount available for borrowings under the credit facility.

The obligations of the Company under the Credit Facility are guaranteed by certain of our domestic subsidiaries (the "Subsidiary Guarantors") and are secured by substantially all of the assets of the Company and the Subsidiary Guarantors, including but not limited to: (a) pledges of and perfected first-priority security interests in 100% of the equity interests of certain of the Company's and the Subsidiary Guarantors' domestic subsidiaries and 65% of the equity interests of certain of the Company's and the Subsidiary Guarantors' first-tier foreign subsidiaries and (b) perfected first-priority security interests in substantially all other tangible and intangible assets of the Company and each Subsidiary Guarantor, subject to certain exceptions. The Credit Agreement contains affirmative and negative covenants that we believe are usual and customary for a senior secured credit agreement. The negative covenants include, among other things, limitations on capital expenditures, asset sales, mergers and acquisitions, indebtedness, liens, dividends, investments and transactions with our affiliates. The Credit Agreement also requires us to maintain a maximum leverage ratio, provided there are revolving loans outstanding. We were in compliance with the covenants in the Credit Agreement at June 30, 2012.

Fair Value of Debt

As of June 30, 2012, the estimated fair value of our long-term debt amounted to \$1,831.5 million. The estimates of fair value are based on the market prices for our publicly-traded debt as of June 30, 2012. The estimates presented on long-term financial instruments are not necessarily indicative of the amounts that would be realized in a current market exchange.

Note 7 Derivatives

We are exposed to interest rate risk on our variable rate borrowings. Accordingly, interest rate fluctuations affect the amount of interest expense we are obligated to pay. In August 2011, we purchased three interest rate caps for an aggregate amount of approximately \$1.1 million with an aggregate notional amount of \$925 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility when one-month LIBOR exceeds 1.25%. The interest rate cap agreements each had an effective date of August 16, 2011 and each mature on August 16, 2013. The unamortized portion of the \$1.1 million investment is recorded in "Other assets" on the consolidated balance sheet and is being amortized over the remaining life of the interest rate caps to interest expense. We are exposed to credit loss in the event of non-performance by the counterparties; however, non-performance is not anticipated.

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 7 Derivatives (Continued)**

ASC 815 requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. In accordance with ASC 815, we designated our interest rate derivatives as cash flow hedges. The fair values of the interest rate derivatives are based on quoted market prices for similar instruments from commercial banks. The following table presents the fair value of our interest rate derivatives included in the consolidated balance sheets for the periods presented (*in millions*):

	Asset Derivatives				Liability Derivatives			
	June 30, 2012		December 31, 2011		June 30, 2012		December 31, 2011	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives Designated as Hedging Instruments Under ASC 815								
Aggregate \$925 million notional interest rate caps	Other assets	\$ 0.1	Other assets	\$ 1.0	Other accrued expenses	\$ 0	Other accrued expenses	\$ 0

The earnings impact of the interest rate derivatives designated as cash flow hedges is recorded upon the recognition of the interest related to the hedged debt. Any ineffectiveness in the hedging relationships is recognized in current earnings. There was no significant ineffectiveness in the first six months of 2012 or 2011. Unrealized gains or losses on the interest rate derivatives are included as a component of "Accumulated other comprehensive income." At June 30, 2012, there was a net unrealized loss totaling \$0.3 million, net of tax benefits of \$0.2 million. At December 31, 2011, there was a net unrealized gain totaling \$0.1 million, net of tax benefits of less than \$0.1 million. The

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 7 Derivatives (Continued)**

following table presents the effect of the interest rate derivatives on our statement of equity and consolidated statements of operations for the periods presented (*in millions*):

	Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended June 30,		Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended June 30,	
	2012	2011		2012	2011
Derivatives in ASC 815 Cash Flow Hedging Relationships					
Aggregate \$925 million notional interest rate caps	\$ 0	N/A	Interest expense	\$ 0	N/A
\$650 million notional interest rate swap*	N/A	\$ (0.4)	Interest expense	N/A	\$ (15.5)
\$250 million notional interest rate cap*	N/A	\$ 0.1	N/A	N/A	\$ 0

	Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion) Six Months Ended June 30,		Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Six Months Ended June 30,	
	2012	2011		2012	2011
Derivatives in ASC 815 Cash Flow Hedging Relationships					
Aggregate \$925 million notional interest rate caps	\$ (0.6)	N/A	Interest expense	\$ 0	N/A
\$650 million notional interest rate swap*	N/A	\$ 2.1	Interest expense	N/A	\$ (18.6)
\$250 million notional interest rate cap*	N/A	\$ 0.3	N/A	N/A	\$ 0

*

In May 2011, we de-designated our \$650 million notional interest rate swap and entered into a swap termination agreement. Our \$250 million notional interest rate cap matured on June 30, 2011.

Note 8 Commitments and Contingencies

We are involved in litigation and disputes arising in the ordinary course of business, such as actions related to injuries; property damage; handling, storage or disposal of vehicles; environmental laws and regulations; and other litigation incidental to the business such as employment matters and dealer disputes. Management considers the likelihood of loss or the incurrance of a liability, as well as the ability to reasonably estimate the amount of loss, in determining loss contingencies. We accrue an estimated loss contingency when it is probable that a liability has been incurred and the amount of loss (or range of possible losses) can be reasonably estimated. Management regularly evaluates current information available to determine whether accrual amounts should be adjusted. Accruals for contingencies including litigation and environmental matters are included in "Other accrued expenses" at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 8 Commitments and Contingencies (Continued)**

technical or legal information becomes available. If the amount of an actual loss is greater than the amount accrued, this could have an adverse impact on our operating results in that period. Legal fees are expensed as incurred. There has been no significant change in the legal and regulatory proceedings which were disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

Note 9 Accumulated Other Comprehensive Income

Accumulated other comprehensive income, net of related tax effects, consisted of the following (*in millions*):

	June 30, 2012	December 31, 2011
Foreign currency translation gain	\$ 28.9	\$ 27.8
Unrealized gain (loss) on interest rate derivatives	(0.3)	0.1
Unrealized gain on postretirement benefit obligation	0.2	0.2
Accumulated other comprehensive income	\$ 28.8	\$ 28.1

Note 10 Fair Value Measurements

We apply ASC 820, *Fair Value Measurements and Disclosures*, to our financial assets and liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The standard establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active; or other inputs that are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities, such as models or other valuation methodologies.

Level 3 Unobservable inputs that are based on our assumptions, are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Unobservable inputs reflect our own assumptions about how market participants would price the asset or liability.

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 10 Fair Value Measurements (Continued)**

The following tables summarize our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 (*in millions*):

Description	June 30, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Interest rate caps	\$ 0.1	\$ 0	\$ 0.1	\$ 0

Description	December 31, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Interest rate caps	\$ 1.0	\$ 0	\$ 1.0	\$ 0

Interest Rate Caps Under the three interest rate cap agreements purchased in August 2011, we receive interest on a notional amount when one-month LIBOR exceeds 1.25%. These agreements effectively hedge a portion of the Term Loan B credit facility. The fair value of the interest rate caps is based on quoted market prices for similar instruments from commercial banks.

Note 11 Segment Information

ASC 280, *Segment Reporting*, requires reporting of segment information that is consistent with the manner in which the chief operating decision maker operates and views the Company. Our operations are grouped into three operating segments: ADESA Auctions, IAA and AFC, which also serve as our reportable business segments. None of our operating segments have been aggregated in our segment reporting. These reportable business segments offer different services and have fundamental differences in their operations.

The holding company is maintained separately from the three reportable segments and includes expenses associated with the corporate office, such as salaries, benefits, and travel costs for the corporate management team, certain human resources, information technology and accounting costs, and certain insurance, treasury, legal and risk management costs. Holding company interest expense includes the interest expense incurred on the corporate debt structure. Intercompany charges relate primarily to interest on intercompany debt or receivables and certain information technology costs allocated by the holding company.

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 11 Segment Information (Continued)**Financial information regarding our reportable segments is set forth below for the three months ended June 30, 2012 (*in millions*):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	\$ 263.8	\$ 177.3	\$ 46.8	\$ 0	\$ 487.9
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	147.4	105.4	10.4	0	263.2
Selling, general and administrative	61.3	18.2	5.8	18.2	103.5
Depreciation and amortization	25.1	16.6	5.8	0.5	48.0
Total operating expenses	233.8	140.2	22.0	18.7	414.7
Operating profit (loss)	30.0	37.1	24.8	(18.7)	73.2
Interest expense	0.3	0.4	3.7	25.2	29.6
Other (income) expense, net	(0.6)	0	0	0.1	(0.5)
Intercompany expense (income)	15.3	9.5	(4.4)	(20.4)	0
Income (loss) before income taxes	15.0	27.2	25.5	(23.6)	44.1
Income taxes	7.7	11.0	9.3	(7.8)	20.2
Net income (loss)	\$ 7.3	\$ 16.2	\$ 16.2	\$ (15.8)	\$ 23.9
Assets	\$ 2,342.7	\$ 1,168.3	\$ 1,319.8	\$ 37.8	\$ 4,868.6

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 11 Segment Information (Continued)**

Financial information regarding our reportable segments is set forth below for the three months ended June 30, 2011 (*in millions*):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	\$ 257.5	\$ 173.2	\$ 42.0	\$ 0	\$ 472.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	143.7	101.0	9.7	0	254.4
Selling, general and administrative	52.4	19.0	5.5	22.5	99.4
Depreciation and amortization	21.0	16.1	6.2	0.3	43.6
Total operating expenses	217.1	136.1	21.4	22.8	397.4
Operating profit (loss)	40.4	37.1	20.6	(22.8)	75.3
Interest expense	0.3	0.5	3.0	45.9	49.7
Other (income) expense, net	(0.4)	(6.3)	0	0	(6.7)
Loss on extinguishment of debt	0	0	0	53.5	53.5
Intercompany expense (income)	9.5	9.6	(3.6)	(15.5)	0
Income (loss) before income taxes	31.0	33.3	21.2	(106.7)	(21.2)
Income taxes	13.1	12.6	8.1	(40.7)	(6.9)
Net income (loss)	\$ 17.9	\$ 20.7	\$ 13.1	\$ (66.0)	\$ (14.3)
Assets	\$ 2,232.9	\$ 1,170.3	\$ 1,204.7	\$ 41.2	\$ 4,649.1

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 11 Segment Information (Continued)**

Financial information regarding our reportable segments is set forth below for the six months ended June 30, 2012 (*in millions*):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	\$ 534.4	\$ 366.7	\$ 93.7	\$ 0	\$ 994.8
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	295.4	216.8	20.4	0	532.6
Selling, general and administrative	128.0	37.9	11.1	40.6	217.6
Depreciation and amortization	50.1	33.7	11.9	0.9	96.6
Total operating expenses	473.5	288.4	43.4	41.5	846.8
Operating profit (loss)	60.9	78.3	50.3	(41.5)	148.0
Interest expense	0.6	0.8	7.4	51.1	59.9
Other (income) expense, net	(1.1)	0.7	0	0	(0.4)
Intercompany expense (income)	30.2	19.2	(8.5)	(40.9)	0
Income (loss) before income taxes	31.2	57.6	51.4	(51.7)	88.5
Income taxes	14.9	23.1	18.9	(18.3)	38.6
Net income (loss)	\$ 16.3	\$ 34.5	\$ 32.5	\$ (33.4)	\$ 49.9

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 11 Segment Information (Continued)**

Financial information regarding our reportable segments is set forth below for the six months ended June 30, 2011 (*in millions*):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	\$ 525.8	\$ 349.1	\$ 82.5	\$ 0	\$ 957.4
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	298.7	201.4	18.8	0	518.9
Selling, general and administrative	107.5	39.6	10.6	44.4	202.1
Depreciation and amortization	42.4	32.5	12.4	0.4	87.7
Total operating expenses	448.6	273.5	41.8	44.8	808.7
Operating profit (loss)	77.2	75.6	40.7	(44.8)	148.7
Interest expense	0.5	1.1	5.1	76.2	82.9
Other (income) expense, net	(0.7)	(6.6)	0	0	(7.3)
Loss on extinguishment of debt	0	0	0	53.5	53.5
Intercompany expense (income)	22.7	19.2	(6.8)	(35.1)	0
Income (loss) before income taxes	54.7	61.9	42.4	(139.4)	19.6
Income taxes	11.0	22.0	14.3	(53.2)	(5.9)
Net income (loss)	\$ 43.7	\$ 39.9	\$ 28.1	\$ (86.2)	\$ 25.5

Note 12 Supplemental Guarantor Information

Our obligations related to the floating rate senior notes are guaranteed on a full, unconditional, joint and several basis by certain direct and indirect present and future domestic subsidiaries (the "Guarantor Subsidiaries"). AFC Funding Corporation and all of our foreign subsidiaries are not guarantors (the "Non-Guarantor Subsidiaries"). The following financial information sets forth, on a condensed consolidating basis, the balance sheets, statements of operations, statements of comprehensive income and statements of cash flows for the periods indicated for KAR Auction Services, the Guarantor Subsidiaries, the Non-Guarantor Subsidiaries and the eliminations to arrive at KAR Auction Services on a consolidated basis.

The condensed consolidating financial statements are provided as an alternative to filing separate financial statements of the Guarantor Subsidiaries. The condensed consolidating financial statements should be read in conjunction with our consolidated financial statements and notes thereto.

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Operations
For the Three Months Ended June 30, 2012
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	\$ 0	\$ 364.2	\$ 123.7	\$ 0	\$ 487.9
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	0	224.3	38.9	0	263.2
Selling, general and administrative	2.7	86.0	14.8	0	103.5
Depreciation and amortization	0	42.2	5.8	0	48.0
Total operating expenses	2.7	352.5	59.5	0	414.7
Operating profit (loss)	(2.7)	11.7	64.2	0	73.2
Interest expense	11.3	14.0	4.3	0	29.6
Other (income) expense, net	0	(0.2)	(0.3)	0	(0.5)
Intercompany expense (income)	0	(4.9)	4.9	0	0
Income (loss) before income taxes	(14.0)	2.8	55.3	0	44.1
Income taxes	(4.6)	5.0	19.8	0	20.2
Net income (loss)	\$ (9.4)	\$ (2.2)	\$ 35.5	\$ 0	\$ 23.9

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Operations
For the Three Months Ended June 30, 2011
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	\$ 0	\$ 348.3	\$ 124.4	\$ 0	\$ 472.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	0	212.6	41.8	0	254.4
Selling, general and administrative	8.4	78.0	13.0	0	99.4
Depreciation and amortization	0	37.3	6.3	0	43.6
Total operating expenses	8.4	327.9	61.1	0	397.4
Operating profit (loss)	(8.4)	20.4	63.3	0	75.3
Interest expense	31.2	15.0	3.5	0	49.7
Other income, net	0	(6.3)	(0.4)	0	(6.7)
Loss on extinguishment of debt	53.5	0	0	0	53.5
Intercompany expense (income)	0	(4.7)	4.7	0	0
Income (loss) before income taxes	(93.1)	16.4	55.5	0	(21.2)
Income taxes	(33.7)	8.1	18.7	0	(6.9)
Net income (loss)	\$ (59.4)	\$ 8.3	\$ 36.8	\$ 0	\$ (14.3)

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)****Condensed Consolidating Statement of Operations
For the Six Months Ended June 30, 2012****(In millions)
(Unaudited)**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	\$ 0	\$ 755.7	\$ 239.1	\$ 0	\$ 994.8
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	0	457.1	75.5	0	532.6
Selling, general and administrative	8.8	177.4	31.4	0	217.6
Depreciation and amortization	0	84.4	12.2	0	96.6
Total operating expenses	8.8	718.9	119.1	0	846.8
Operating profit (loss)	(8.8)	36.8	120.0	0	148.0
Interest expense	22.9	28.5	8.5	0	59.9
Other (income) expense, net	0	0.4	(0.8)	0	(0.4)
Intercompany expense (income)	0	(9.0)	9.0	0	0
Income (loss) before income taxes	(31.7)	16.9	103.3	0	88.5
Income taxes	(11.2)	13.2	36.6	0	38.6
Net income (loss)	\$ (20.5)	\$ 3.7	\$ 66.7	\$ 0	\$ 49.9

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Operations
For the Six Months Ended June 30, 2011
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	\$ 0	\$ 723.6	\$ 233.8	\$ 0	\$ 957.4
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	0	437.6	81.3	0	518.9
Selling, general and administrative	12.6	162.4	27.1	0	202.1
Depreciation and amortization	0	75.3	12.4	0	87.7
Total operating expenses	12.6	675.3	120.8	0	808.7
Operating profit (loss)	(12.6)	48.3	113.0	0	148.7
Interest expense	46.6	30.3	6.0	0	82.9
Other income, net	0	(6.5)	(0.8)	0	(7.3)
Loss on extinguishment of debt	53.5	0	0	0	53.5
Intercompany expense (income)	0	(8.7)	8.7	0	0
Income (loss) before income taxes	(112.7)	33.2	99.1	0	19.6
Income taxes	(41.1)	1.0	34.2	0	(5.9)
Net income (loss)	\$ (71.6)	\$ 32.2	\$ 64.9	\$ 0	\$ 25.5

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the Three Months Ended June 30, 2012
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net income (loss)	\$ (9.4)	\$ (2.2)	\$ 35.5	\$ 0	\$ 23.9
Other comprehensive income (loss)					
Foreign currency translation gain (loss)	0	0	(4.7)	0	(4.7)
Unrealized gain (loss) on interest rate derivatives, net of tax	0	0	0	0	0
Total other comprehensive income (loss)	0	0	(4.7)	0	(4.7)
Comprehensive income (loss)	\$ (9.4)	\$ (2.2)	\$ 30.8	\$ 0	\$ 19.2

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Comprehensive Income (Loss)
For the Three Months Ended June 30, 2011
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net income (loss)	\$ (59.4)	\$ 8.3	\$ 36.8	\$ 0	\$ (14.3)
Other comprehensive income					
Foreign currency translation gain	0	0	2.0	0	2.0
Unrealized gain (loss) on interest rate derivatives, net of tax	(0.1)	0	0	0	(0.1)
Early termination of swap agreement	9.0	0	0	0	9.0
Total other comprehensive income	8.9	0	2.0	0	10.9
Comprehensive income (loss)	\$ (50.5)	\$ 8.3	\$ 38.8	\$ 0	\$ (3.4)

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)****Condensed Consolidating Statement of Comprehensive Income (Loss)****For the Six Months Ended June 30, 2012****(In millions)****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net income (loss)	\$ (20.5)	\$ 3.7	\$ 66.7	\$ 0	\$ 49.9
Other comprehensive income					
Foreign currency translation gain	0	0	1.1	0	1.1
Unrealized gain (loss) on interest rate derivatives, net of tax	(0.4)	0	0	0	(0.4)
Total other comprehensive income	(0.4)	0	1.1	0	0.7
Comprehensive income (loss)	\$ (20.9)	\$ 3.7	\$ 67.8	\$ 0	\$ 50.6

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)****Condensed Consolidating Statement of Comprehensive Income (Loss)
For the Six Months Ended June 30, 2011****(In millions)
(Unaudited)**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net income (loss)	\$ (71.6)	\$ 32.2	\$ 64.9	\$ 0	\$ 25.5
Other comprehensive income					
Foreign currency translation gain	0	0	10.1	0	10.1
Unrealized gain (loss) on interest rate derivatives, net of tax	1.5	0	0	0	1.5
Early termination of swap agreement	9.0	0	0	0	9.0
Total other comprehensive income	10.5	0	10.1	0	20.6
Comprehensive income (loss)	\$ (61.1)	\$ 32.2	\$ 75.0	\$ 0	\$ 46.1

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)****Condensed Consolidating Balance Sheet****As of June 30, 2012****(In millions)****(Unaudited)**

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
Current assets					
Cash and cash equivalents	\$ 0	\$ 80.3	\$ 36.8	\$ 0	\$ 117.1
Restricted cash	0	1.8	7.5	0	9.3
Trade receivables, net of allowances	0	308.0	74.6	(24.2)	358.4
Finance receivables, net of allowances	0	7.4	919.1	0	926.5
Deferred income tax assets	0	37.5	0	0	37.5
Other current assets	0.9	57.1	8.1	0	66.1
Total current assets	0.9	492.1	1,046.1	(24.2)	1,514.9
Other assets					
Investments in and advances to affiliates, net	2,408.0	361.2	148.0	(2,917.2)	0
Goodwill	0	1,674.8	4.7	0	1,679.5
Customer relationships, net of accumulated amortization	0	557.3	101.0	0	658.3
Other intangible assets, net of accumulated amortization	0	295.4	1.8	0	297.2
Unamortized debt issuance costs	21.0	0	4.1	0	25.1
Other assets	0.1	8.7	0.6	0	9.4
Total other assets	2,429.1	2,897.4	260.2	(2,917.2)	2,669.5
Property and equipment, net of accumulated depreciation	0	554.0	130.2	0	684.2
Total assets	\$ 2,430.0	\$ 3,943.5	\$ 1,436.5	\$ (2,941.4)	\$ 4,868.6

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Balance Sheet
As of June 30, 2012
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	\$ 0	\$ 431.2	\$ 45.7	\$ (24.2)	\$ 452.7
Accrued employee benefits and compensation expenses	0	46.8	5.7	0	52.5
Accrued interest	2.1	0	0.2	0	2.3
Other accrued expenses	0.1	55.9	11.6	0	67.6
Income taxes payable	0	13.8	0	0	13.8
Obligations collateralized by finance receivables	0	0	634.1	0	634.1
Current maturities of long-term debt	17.0	0	0	0	17.0
Total current liabilities	19.2	547.7	697.3	(24.2)	1,240.0
Non-current liabilities					
Investments by and advances from affiliates, net	145.3	0	0	(145.3)	0
Long-term debt	987.6	821.5	0	0	1,809.1
Deferred income tax liabilities	(0.2)	289.3	22.4	0	311.5
Other liabilities	0	82.9	16.8	0	99.7
Total non-current liabilities	1,132.7	1,193.7	39.2	(145.3)	2,220.3
Commitments and contingencies					
Stockholders' equity					
Total stockholders' equity	1,278.1	2,202.1	700.0	(2,771.9)	1,408.3
Total liabilities and stockholders' equity	\$ 2,430.0	\$ 3,943.5	\$ 1,436.5	\$ (2,941.4)	\$ 4,868.6

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Balance Sheet
As of December 31, 2011
(In millions)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
<i>Current assets</i>					
Cash and cash equivalents	\$ 0	\$ 68.3	\$ 29.1	\$ 0	\$ 97.4
Restricted cash	0	0	8.2	0	8.2
Trade receivables, net of allowances	0	256.8	59.4	(18.8)	297.4
Finance receivables, net of allowances	0	5.5	868.7	0	874.2
Deferred income tax assets	0	37.5	0	0	37.5
Other current assets	1.5	49.9	7.1	0	58.5
Total current assets	1.5	418.0	972.5	(18.8)	1,373.2
<i>Other assets</i>					
Investments in and advances to affiliates, net	2,475.5	285.5	130.8	(2,891.8)	0
Goodwill	0	1,674.8	4.7	0	1,679.5
Customer relationships, net of accumulated amortization	0	588.6	105.4	0	694.0
Other intangible assets, net of accumulated amortization	0	301.4	4.5	0	305.9
Unamortized debt issuance costs	23.5	0	5.1	0	28.6
Other assets	1.0	9.6	0.6	0	11.2
Total other assets	2,500.0	2,859.9	251.1	(2,891.8)	2,719.2
Property and equipment, net of accumulated depreciation	0	555.4	131.3	0	686.7
Total assets	\$ 2,501.5	\$ 3,833.3	\$ 1,354.9	\$ (2,910.6)	\$ 4,779.1

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Balance Sheet
As of December 31, 2011
(In millions)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders' Equity					
Current liabilities					
Accounts payable	\$ 0	\$ 351.7	\$ 34.9	\$ (18.8)	\$ 367.8
Accrued employee benefits and compensation expenses	0	52.8	4.9	0	57.7
Accrued interest	2.1	0	0.2	0	2.3
Other accrued expenses	0.4	61.5	9.8	0	71.7
Income taxes payable	0	0.5	0	0	0.5
Obligations collateralized by finance receivables	0	0	610.3	0	610.3
Current maturities of long-term debt	85.9	0	0	0	85.9
Total current liabilities	88.4	466.5	660.1	(18.8)	1,196.2
Non-current liabilities					
Investments by and advances from affiliates, net	119.9	0	0	(119.9)	0
Long-term debt	995.4	821.5	0	0	1,816.9
Deferred income tax liabilities	0	300.2	23.7	0	323.9
Other liabilities	0	82.4	16.5	0	98.9
Total non-current liabilities	1,115.3	1,204.1	40.2	(119.9)	2,239.7
Commitments and contingencies					
Stockholders' equity					
Total stockholders' equity	1,297.8	2,162.7	654.6	(2,771.9)	1,343.2
Total liabilities and stockholders' equity	\$ 2,501.5	\$ 3,833.3	\$ 1,354.9	\$ (2,910.6)	\$ 4,779.1

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2012
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash (used by) provided by operating activities	\$ 76.2	\$ 48.6	\$ 45.5	\$ 0	\$ 170.3
Investing activities					
Net decrease (increase) in finance receivables held for investment	0	(1.9)	(54.4)	0	(56.3)
Acquisition of businesses, net of cash acquired	0	(0.5)	0	0	(0.5)
Purchases of property, equipment and computer software	0	(35.0)	(2.3)	0	(37.3)
Proceeds from sale of property and equipment	0	0.1	0	0	0.1
(Increase) decrease in restricted cash	0	(1.8)	0.7	0	(1.1)
Net cash (used by) provided by investing activities	0	(39.1)	(56.0)	0	(95.1)
Financing activities					
Net increase (decrease) in book overdrafts	0	12.7	(4.9)	0	7.8
Net decrease in borrowings on lines of credit	(68.9)	0	0	0	(68.9)
Net increase (decrease) in obligations collateralized by finance receivables	0	0	23.8	0	23.8
Payments on long-term debt	(8.5)	0	0	0	(8.5)
Payments on capital leases	0	(6.5)	(0.3)	0	(6.8)
Payments of contingent consideration and deferred acquisition costs	0	(3.7)	0	0	(3.7)
Issuance of common stock under stock plans	1.2	0	0	0	1.2
Net cash provided by (used by) financing activities	(76.2)	2.5	18.6	0	(55.1)
Effect of exchange rate changes on cash	0	0	(0.4)	0	(0.4)
Net increase (decrease) in cash and cash equivalents	0	12.0	7.7	0	19.7
Cash and cash equivalents at beginning of period	0	68.3	29.1	0	97.4
Cash and cash equivalents at end of period	\$ 0	\$ 80.3	\$ 36.8	\$ 0	\$ 117.1

Table of Contents**KAR Auction Services, Inc.****Notes to Consolidated Financial Statements (Continued)****June 30, 2012 (Unaudited)****Note 12 Supplemental Guarantor Information (Continued)**

Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2011
(In millions)
(Unaudited)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash (used by) provided by operating activities	\$ 72.6	\$ 35.8	\$ 49.1	\$ 0	\$ 157.5
Investing activities					
Net decrease (increase) in finance receivables held for investment	0	3.2	(21.6)	0	(18.4)
Acquisition of businesses, net of cash acquired	0	(4.2)	0	0	(4.2)
Purchases of property, equipment and computer software	0	(38.7)	(0.6)	0	(39.3)
(Increase) decrease in restricted cash	0	0	1.8	0	1.8
Net cash (used by) provided by investing activities	0	(39.7)	(20.4)	0	(60.1)
Financing activities					
Net increase (decrease) in book overdrafts	0	49.9	(0.4)	0	49.5
Net increase (decrease) in obligations collateralized by finance receivables	0	0	16.3	0	16.3
Proceeds from long-term debt	1,691.5	0	0	0	1,691.5
Payments for debt issuance costs	(24.3)	(5.1)	(1.0)	0	(30.4)
Payments on long-term debt	(1,144.6)	0	0	0	(1,144.6)
Payments for early extinguishment of debt	(600.7)	0	0	0	(600.7)
Payments on capital leases	0	(2.1)	(0.2)	0	(2.3)
Payments of contingent consideration and deferred acquisition costs	0	(2.3)	0	0	(2.3)
Issuance of common stock under stock plans	5.5	0	0	0	5.5
Net cash provided by (used by) financing activities	(72.6)	40.4	14.7	0	(17.5)
Effect of exchange rate changes on cash	0	0	1.3	0	1.3
Net increase (decrease) in cash and cash equivalents	0	36.5	44.7	0	81.2
Cash and cash equivalents at beginning of period	0	99.3	19.8	0	119.1
Cash and cash equivalents at end of period	\$ 0	\$ 135.8	\$ 64.5	\$ 0	\$ 200.3

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and which are subject to certain risks, trends and uncertainties. In particular, statements made in this report on Form 10-Q that are not historical facts (including, but not limited to, expectations, estimates, assumptions and projections regarding the industry, business, future operating results, potential acquisitions and anticipated cash requirements) may be forward-looking statements. Words such as "should," "may," "will," "anticipates," "expects," "intends," "plans," "believes," "seeks," "estimates" and similar expressions identify forward-looking statements. Such statements, including statements regarding our future growth; anticipated cost savings, revenue increases and capital expenditures; strategic initiatives, greenfields and acquisitions; our competitive position; and our continued investment in information technology are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from the results projected, expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Item 1A "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011 filed on February 28, 2012. Some of these factors include:

fluctuations in consumer demand for and in the supply of used, leased and salvage vehicles and the resulting impact on auction sales volumes, conversion rates and loan transaction volumes;

trends in new and used vehicle sales and incentives, including wholesale used vehicle pricing;

the ability of consumers to lease or finance the purchase of new and/or used vehicles;

the ability to recover or collect from delinquent or bankrupt customers;

economic conditions including fuel prices, foreign exchange rates and interest rate fluctuations;

trends in the vehicle remarketing industry;

changes in the volume of vehicle production, including capacity reductions at the major original equipment manufacturers;

increases in the number of used and salvage vehicles purchased on virtual auction platforms;

the introduction of new competitors;

laws, regulations and industry standards, including changes in regulations governing the sale of used vehicles, the processing of salvage vehicles and commercial lending activities;

changes in the market value of vehicles auctioned, including changes in the actual cash value of salvage vehicles;

competitive pricing pressures;

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

costs associated with the acquisition of businesses or technologies;

litigation developments;

our ability to successfully implement our business strategies or realize expected cost savings and revenue enhancements;

our ability to develop and implement information systems responsive to customer needs;

business development activities, including acquisitions and integration of acquired businesses;

the costs of environmental compliance and/or the imposition of liabilities under environmental laws and regulations;

Table of Contents

weather;

general business conditions;

our substantial amount of debt;

restrictive covenants in our debt agreements;

our assumption of the settlement risk for vehicles sold;

any impairment to our goodwill or other intangible assets;

our self-insurance for certain risks;

any losses of key personnel;

interruptions to service from our workforce;

changes in effective tax rates;

changes to accounting standards; and

other risks described from time to time in our filings with the SEC.

Many of these risk factors are outside of our control, and as such, they involve risks which are not currently known that could cause actual results to differ materially from those discussed or implied herein. The forward-looking statements in this document are made as of the date on which they are made and we do not undertake to update our forward-looking statements.

Our future growth depends on a variety of factors, including our ability to increase vehicle sold volumes and loan transaction volumes, expand our product and service offerings including information systems development, acquire and integrate additional business entities, manage expansion, control costs in our operations, introduce fee increases, and retain our executive officers and key employees. Certain initiatives that management considers important to our long-term success include projects involving substantial capital investment in e-business, information technology, facility relocations and expansions, as well as operating initiatives designed to enhance overall efficiencies, all of which have significant risks associated with their execution, and could take several years to yield any direct monetary benefits. Accordingly, we cannot predict whether our growth strategy will be successful. In addition, we cannot predict what portion of overall sales will be conducted through online auctions or other remarketing methods in the future and what impact this may have on our auction business.

Overview

We provide whole car and salvage auction services in North America. Our business is divided into three reportable business segments, each of which is an integral part of the vehicle remarketing industry: ADESA Auctions, IAA and AFC.

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

The ADESA Auctions segment serves an international customer base through online auctions and through 68 whole car auction facilities in North America, that are developed and strategically located to draw professional sellers and buyers together and allow the buyers to inspect and compare vehicles remotely or in person. ADESA OpenLane, a leader in internet-based remarketing solutions, offers vehicles for sale from any location. Vehicles at ADESA's auctions are typically sold by commercial fleet operators, financial institutions, rental car companies, new and used vehicle dealers and vehicle manufacturers and their captive finance companies to franchise and independent used vehicle dealers. ADESA also provides value-added ancillary services including inspections, storage, transportation, reconditioning and titling and other administrative services.

Table of Contents

The IAA segment serves a domestic and international customer base through live and online auctions and through 161 salvage vehicle auction sites in North America at June 30, 2012. The salvage auctions facilitate the remarketing of damaged or low value vehicles designated as total losses by insurance companies and charity donation vehicles, as well as recovered stolen (or theft) vehicles. The salvage auction business specializes in providing services such as transportation, titling, salvage recovery and claims settlement administrative services.

The AFC segment provides short-term, inventory-secured financing, known as floorplan financing, primarily to independent used vehicle dealers. At June 30, 2012, AFC conducted business at 104 locations in North America.

The holding company is maintained separately from the three reportable segments and includes expenses associated with the corporate office, such as salaries, benefits, and travel costs for our management team, certain human resources, information technology and accounting costs, and certain insurance, treasury, legal and risk management costs. Holding company interest expense includes the interest expense incurred on the corporate debt structure. Intercompany charges relate primarily to interest on intercompany debt or receivables and certain information technology costs allocated by the holding company.

Industry Trends

Whole Car

In 2010 and 2011, the North American whole car auction industry experienced supply shortages as a result of the impacts felt by the automotive industry over the last three years, including volatility in new vehicle sales, lease originations and repossessions. The supply shortages resulted in a decline in whole car auction volume compared to prior years. Used vehicles sold in North America through whole car auctions were 9.1 million, 8.4 million and 7.7 million (excluding approximately 0.3 million used vehicles sold by OPENLANE in 2011) in 2009, 2010, and 2011, respectively. The supply shortages and resulting decline in industry auction volumes reflect a reduction in units sold by institutional consignors. This reduction has been partially offset by an increase in dealer consignment units sold in 2010 and 2011.

Other reasons for the fluctuations in industry volumes, which may also impact future volumes include:

New car sales in the U.S. declined from 17.0 million in 2005 to 10.4 million in 2009. Although new vehicle sales have climbed over the last two years to approximately 12.8 million units in 2011, they are not anticipated to return to 2005 levels for the foreseeable future.

The drop in total new vehicle sales, coupled with a tightening of consumer credit and changing policies regarding delinquent loans by the major lenders, resulted in a decline in repossessed vehicles coming to auction.

When lease residuals are below wholesale vehicle values, more vehicles are purchased upstream by either the consumer or the grounding dealer or by dealers in online auctions, prior to the vehicles being transported to a physical auction.

As used vehicle prices have increased over the last few years, dealers have shifted to selling more used vehicles, which can offset lower new vehicle sales. Dealers can also offer financing, warranties and insurance services on their used vehicle sales. As a result, dealers are receiving more trade-ins and despite an increase in the number of trade-ins they keep for retail sale, the number of trade-ins remarketed through whole car auctions has increased.

There was a reduction in the number of lease originations in 2008 and 2009, as new vehicle sales fell and lease financing was scaled back. We believe this decline will continue to negatively impact the supply of off-lease vehicles available at auction in 2012 and this trend could continue into 2013.

Table of Contents

Based on the factors discussed above, we estimate that used vehicle auction volumes in North America, including units sold by OPENLANE, will be approximately 8 million units in 2012, approach 8.4 million units in 2013 and are expected to reach nearly 9 million units by 2015.

Salvage

Vehicles deemed a total loss by automobile insurance companies represent the largest category of vehicles sold in the salvage vehicle auction industry. The percentage of claims resulting in total losses is estimated at 13.9% for 2011, down slightly from 2010. There is no central reporting system that tracks the number of total loss vehicles in any given year which makes estimating industry volumes very difficult.

Automotive Finance

In 2008 and 2009, the overall economy and in particular the automotive finance industries faced pressures, which negatively affected the used vehicle dealer base. Used vehicle dealers experienced a significant decline in sales which resulted in a decrease in consumer auto loan originations and an increased number of dealers defaulting on their loans, which increased credit losses. In addition, the value of recovered collateral on defaulted loans was impacted to some degree by the volatility in the vehicle pricing market. To the extent these negative trends recur, they could have a material adverse impact on AFC's results of operations.

Despite the negative factors and trends that impacted the automotive finance industry in 2008 and 2009, AFC's financial results have steadily improved since that time. AFC implemented a number of strategic initiatives in 2008 and early 2009 designed to tighten credit standards and reduce risk and exposure in its portfolio of finance receivables. These initiatives have resulted in a substantial improvement in the aging of the managed portfolio, which was over 99 percent current at June 30, 2012. In addition, AFC's managed portfolio of finance receivables grew over 18 percent from \$789.5 million at June 30, 2011 to \$935.5 million at June 30, 2012.

Seasonality

The volume of vehicles sold at our auctions generally fluctuates from quarter to quarter. This seasonality is caused by several factors including weather, the timing of used vehicles available for sale from selling customers, the availability and quality of salvage vehicles, holidays, and the seasonality of the retail market for used vehicles, which affects the demand side of the auction industry. Used vehicle auction volumes tend to decline during prolonged periods of winter weather conditions. In addition, mild weather conditions and decreases in traffic volume can each lead to a decline in the available supply of salvage vehicles because fewer traffic accidents occur, resulting in fewer damaged vehicles overall. As a result, revenues and operating expenses related to volume will fluctuate accordingly on a quarterly basis. The fourth calendar quarter typically experiences lower used vehicle auction volume as well as additional costs associated with the holidays and winter weather.

Sources of Revenues and Expenses

Our revenue is derived from auction fees and related services at our whole car and salvage auctions, and from dealer financing fees and interest income at AFC. Although auction revenues primarily include the auction services and related fees, our related receivables and payables include the gross value of the vehicles sold.

Our operating expenses consist of cost of services, selling, general and administrative and depreciation and amortization. Cost of services is composed of payroll and related costs, subcontract services, supplies, insurance, property taxes, utilities, maintenance and lease expense related to the auction sites and loan offices. Cost of services excludes depreciation and amortization. Selling, general

Table of Contents

and administrative expenses are composed of payroll and related costs, sales and marketing, information technology services and professional fees.

Results of Operations*Overview of Results of KAR Auction Services for the Three Months Ended June 30, 2012 and 2011:*

(Dollars in millions except per share amounts)	Three Months Ended June 30,	
	2012	2011
Revenues		
ADESA	\$ 263.8	\$ 257.5
IAA	177.3	173.2
AFC	46.8	42.0
Total revenues	487.9	472.7
Cost of services*	263.2	254.4
Gross profit*	224.7	218.3
Selling, general and administrative	103.5	99.4
Depreciation and amortization	48.0	43.6
Operating profit	73.2	75.3
Interest expense	29.6	49.7
Other (income) expense, net	(0.5)	(6.7)
Loss on extinguishment of debt	0	53.5
Income (loss) before income taxes	44.1	(21.2)
Income taxes	20.2	(6.9)
Net income (loss)	\$ 23.9	\$ (14.3)
Net income (loss) per share		
Basic	\$ 0.18	\$ (0.11)
Diluted	\$ 0.17	\$ (0.11)

*

Exclusive of depreciation and amortization

For the three months ended June 30, 2012, we had revenue of \$487.9 million, compared with revenue of \$472.7 million for the three months ended June 30, 2011, an increase of 3%. For a further discussion of revenues, gross profit and selling, general and administrative expenses, see the segment results discussions below.

Depreciation and Amortization

Depreciation and amortization increased \$4.4 million, or 10%, to \$48.0 million for the three months ended June 30, 2012, compared with \$43.6 million for the three months ended June 30, 2011. Approximately \$4.0 million of the increase was representative of OPENLANE's depreciation and amortization in the second quarter of 2012. The remaining increase was representative of increased amortization resulting from certain assets placed in service during 2011 and 2012.

Interest Expense

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Interest expense decreased \$20.1 million, or 40%, to \$29.6 million for the three months ended June 30, 2012, compared with interest expense of \$49.7 million for the three months ended June 30, 2011. The decrease in interest expense was primarily representative of \$14.5 million in interest expense

Table of Contents

incurred in the second quarter of 2011 in connection with the settlement and termination of our \$650 million notional swap agreement. In addition, interest expense decreased as a result of the second quarter 2011 prepayment of our \$450.0 million principal amount 8³/₄% senior notes and the remaining \$131.1 million principal balance of our 10% senior subordinated notes, partially offset by Term Loan B debt which had an interest rate of 5% at June 30, 2012, compared with Old Term Loan B debt which had an interest rate of approximately 3% until its prepayment in May 2011. The decrease in interest expense was also partially offset by an increase in interest expense at AFC, which resulted from an increase in the average U.S. portfolio sold in 2012 as compared with 2011, as well as an increase in the cost of funds, which began in the second quarter of 2011.

Other (Income) Expense

We had other income of \$0.5 million for the three months ended June 30, 2012, compared with \$6.7 million for the three months ended June 30, 2011. The change in other income was primarily representative of \$5.9 million of contingent consideration that was reversed in the second quarter of 2011. The contingent consideration related to certain prior year acquisitions and the adjustments were based on revised forecasts which indicated the unit volumes required during the measurement period in order for the contingent consideration to become payable would not be met.

Loss on Extinguishment of Debt

In May 2011, we terminated our previous credit facility, entered into as of April 20, 2007. In addition, in June 2011, we prepaid \$450.0 million principal amount of the 8³/₄% senior notes and the remaining \$131.1 million principal balance of the 10% senior subordinated notes with proceeds received from Term Loan B and cash on hand. In the second quarter of 2011, we recorded a \$24.5 million pretax charge representative of the write-off of certain unamortized debt issuance costs associated with our Old Term Loan B. In the second quarter of 2011, we also recorded a \$29.0 million pretax charge representative of the net premiums payable related to the repurchase of the 8³/₄% senior notes and the 10% senior subordinated notes, the write-off of certain unamortized debt issuance costs associated with these notes, as well as certain expenses related to the prepayment of these notes.

Income Taxes

We had an effective tax rate of 45.8% for the three months ended June 30, 2012, compared with an effective rate of 32.5% for the three months ended June 30, 2011. Excluding the effect of the discrete items in the second quarter of 2012, our effective tax rate for the three months ended June 30, 2012 would have been 41.7%. Excluding the effect of the discrete items in the second quarter of 2011, our effective tax rate for the three months ended June 30, 2011 would have been 43.9%. Income before income taxes includes the impact of \$1.8 million and \$7.1 million in profit interest expense for the three months ended June 30, 2012 and 2011, respectively, which is not deductible by us for income tax purposes.

Table of ContentsADESA Results

(Dollars in millions)	Three Months Ended June 30,	
	2012	2011
ADESA revenue	\$ 263.8	\$ 257.5
Cost of services*	147.4	143.7
Gross profit*	116.4	113.8
Selling, general and administrative	61.3	52.4
Depreciation and amortization	25.1	21.0
Operating profit	\$ 30.0	\$ 40.4

*
Exclusive of depreciation and amortization

Revenue

Revenue from ADESA increased \$6.3 million, or 2%, to \$263.8 million for the three months ended June 30, 2012, compared with \$257.5 million for the three months ended June 30, 2011. The increase in revenue was primarily a result of an 11% increase in the number of vehicles sold, partially offset by an 8% decrease in revenue per vehicle sold to approximately \$555 for the three months ended June 30, 2012, compared to over \$600 for the three months ended June 30, 2011. OPENLANE accounted for approximately \$21.7 million of ADESA's revenue for the three months ended June 30, 2012.

The 8% decrease in revenue per vehicle sold was attributable to lower revenue per vehicle sold at OPENLANE. In addition, decreases in ancillary and related services resulted in decreased ADESA revenue of approximately \$6.7 million, as well as fluctuations in the Canadian exchange rate, which resulted in decreased ADESA revenue of approximately \$2.7 million. Partially offsetting the decreases in revenue was incremental fee income related to selective fee increases, which resulted in increased ADESA revenue of approximately \$7.1 million.

The total number of used vehicles sold at ADESA increased 11% for the three months ended June 30, 2012, compared with the three months ended June 30, 2011, and resulted in an increase in ADESA revenue of approximately \$8.6 million. Excluding OPENLANE, the total number of used vehicles sold at ADESA decreased 6% for the three months ended June 30, 2012, compared with the three months ended June 30, 2011. The decrease in same store volume sold was attributable to a decline in supplier inventory levels, partially offset by an 11% (excluding OPENLANE) increase in dealer consignment units sold in the second quarter of 2012 compared with the second quarter of 2011. Online sales volume for ADESA in the second quarter of 2012 represented approximately 31% of the total vehicles sold by ADESA, which reflects the OPENLANE acquisition, compared with approximately 22% in the second quarter of 2011.

The used vehicle conversion percentage, calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale at our ADESA auctions, decreased to 55.6% (excluding OPENLANE) for the three months ended June 30, 2012, compared with 60.8% for the three months ended June 30, 2011. The decrease in conversion rate is representative of a change in the mix of vehicles sold toward more dealer consignment vehicles, which convert at a lower rate, as dealers have the option of returning vehicles to their stores for retail sale or utilizing alternative wholesale channels. For the three months ended June 30, 2012, dealer consignment vehicles represented approximately 43% of used vehicles sold at ADESA, an increase from approximately 42% for the three months ended June 30, 2011.

Table of Contents*Gross Profit*

For the three months ended June 30, 2012, gross profit for ADESA increased \$2.6 million, or 2%, to \$116.4 million, compared with \$113.8 million for the three months ended June 30, 2011. Gross profit for ADESA was 44.1% of revenue for the three months ended June 30, 2012, compared with 44.2% of revenue for the three months ended June 30, 2011. The decrease in gross profit as a percentage of revenue for the three months ended June 30, 2012, compared with the three months ended June 30, 2011 was primarily the result of the 3% increase in cost of services. The increase in cost of services was attributable to OPENLANE, as well as the decrease in conversion rates.

Selling, General and Administrative

Selling, general and administrative expenses for the ADESA segment increased \$8.9 million, or 17%, to \$61.3 million for the three months ended June 30, 2012, compared with \$52.4 million for the three months ended June 30, 2011, primarily due to the acquisition and integration of OPENLANE, which accounted for approximately \$9.0 million of the increase, as well as an increase in incentive compensation and professional fees, partially offset by a decrease in compensation expense and fluctuations in the Canadian exchange rate.

IAA Results

(Dollars in millions)	Three Months Ended June 30,	
	2012	2011
IAA revenue	\$ 177.3	\$ 173.2
Cost of services*	105.4	101.0
Gross profit*	71.9	72.2
Selling, general and administrative	18.2	19.0
Depreciation and amortization	16.6	16.1
Operating profit	\$ 37.1	\$ 37.1

*

Exclusive of depreciation and amortization

Revenue

Revenue from IAA increased \$4.1 million, or 2%, to \$177.3 million for the three months ended June 30, 2012, compared with \$173.2 million for the three months ended June 30, 2011. The increase in revenue was a result of an increase in overall vehicles sold of approximately 3% for the three months ended June 30, 2012. Included in the growth of units sold is an increase in the sale of vehicles sold under purchase agreements, in which the entire selling price of the vehicle is recorded as revenue. Vehicles sold under purchase agreements represented approximately 8% of total salvage vehicles sold for the quarter ended June 30, 2012. Online sales volumes for IAA for the three months ended June 30, 2012 and 2011 represented approximately half of the total vehicles sold by IAA.

Gross Profit

For the three months ended June 30, 2012, gross profit at IAA decreased to \$71.9 million, or 40.6% of revenue, compared with \$72.2 million, or 41.7% of revenue, for the three months ended June 30, 2011. The gross profit decrease was primarily the result of the 4% increase in cost of services. The increase in cost of services was attributable to increases in yard and auction expenses specifically pertaining to reconditioning, processing and towing costs related to the increase in volume, as well as the impact of an increase in vehicles sold under purchase agreements, as the cost of the vehicles are included in the cost of services.

Table of Contents*Selling, General and Administrative*

Selling, general and administrative expenses at IAA decreased \$0.8 million, or 4%, to \$18.2 million for the three months ended June 30, 2012, compared with \$19.0 million for the three months ended June 30, 2011. The decrease in selling, general and administrative expenses was attributable to decreases in stock-based compensation expense and incentive-based compensation expense.

AFC Results

(Dollars in millions except volumes and per loan amounts)	Three Months Ended June 30,	
	2012	2011
AFC revenue		
Interest and fee income	\$ 45.6	\$ 39.2
Other revenue	2.7	2.9
Provision for credit losses	(1.5)	(0.1)
Total AFC revenue	46.8	42.0
Cost of services*	10.4	9.7
Gross profit*	36.4	32.3
Selling, general and administrative	5.8	5.5
Depreciation and amortization	5.8	6.2
Operating profit	\$ 24.8	\$ 20.6
Loan transactions	292,954	251,730
Revenue per loan transaction	\$ 160	\$ 167

*

Exclusive of depreciation and amortization

Revenue

For the three months ended June 30, 2012, AFC revenue increased \$4.8 million, or 11%, to \$46.8 million, compared with \$42.0 million for the three months ended June 30, 2011. The increase in revenue was the result of a 16% increase in loan transactions to 292,954 for the three months ended June 30, 2012, compared with the same period in 2011, partially offset by a 4% decrease in revenue per loan transaction for the three months ended June 30, 2012. In addition, managed receivables increased to \$935.5 million at June 30, 2012 from \$789.5 million at June 30, 2011.

Revenue per loan transaction, which includes both loans paid off and loans curtailed, decreased primarily as a result of an increase in the provision for credit losses and a decrease in average loan values, partially offset by an increase in the average portfolio duration.

Gross Profit

For the three months ended June 30, 2012, gross profit for the AFC segment increased \$4.1 million, or 13%, to \$36.4 million, compared with \$32.3 million for the three months ended June 30, 2011, primarily as a result of an 11% increase in revenue, partially offset by a 7% increase in cost of services. The increase in cost of services was primarily the result of an increase in compensation expense associated with an increase in the number of employees.

Selling, General and Administrative Expenses

Selling, general and administrative expenses at AFC increased \$0.3 million, or 5%, for the three months ended June 30, 2012, compared with the three months ended June 30, 2011. The increase was

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

primarily the result of increases in compensation expense and travel costs, partially offset by a decrease in professional fees.

Holding Company Results

(Dollars in millions)	Three Months Ended June 30,	
	2012	2011
Selling, general and administrative	\$ 18.2	\$ 22.5
Depreciation and amortization	0.5	0.3
Operating loss	\$ (18.7)	\$ (22.8)

Selling, General and Administrative Expenses

For the three months ended June 30, 2012, selling, general and administrative expenses at the holding company decreased \$4.3 million, or 19%, to \$18.2 million, compared with \$22.5 million for the three months ended June 30, 2011, primarily as a result of a decrease in stock-based compensation expense, partially offset by increases in compensation expense and professional fees.

Overview of Results of KAR Auction Services for the Six Months Ended June 30, 2012 and 2011:

(Dollars in millions except per share amounts)	Six Months Ended June 30,	
	2012	2011
Revenues		
ADESA	\$ 534.4	\$ 525.8
IAA	366.7	349.1
AFC	93.7	82.5
Total revenues	994.8	957.4
Cost of services*	532.6	518.9
Gross profit*	462.2	438.5
Selling, general and administrative	217.6	202.1
Depreciation and amortization	96.6	87.7
Operating profit	148.0	148.7
Interest expense	59.9	82.9
Other (income) expense, net	(0.4)	(7.3)
Loss on extinguishment of debt	0	53.5
Income before income taxes	88.5	19.6
Income taxes	38.6	(5.9)
Net income	\$ 49.9	\$ 25.5
Net income per share		
Basic	\$ 0.37	\$ 0.19
Diluted	\$ 0.36	\$ 0.19

*

Exclusive of depreciation and amortization

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

For the six months ended June 30, 2012, we had revenue of \$994.8 million, compared with revenue of \$957.4 million for the six months ended June 30, 2011, an increase of 4%. For a further discussion

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

of revenues, gross profit and selling, general and administrative expenses, see the segment results discussions below.

Depreciation and Amortization

Depreciation and amortization increased \$8.9 million, or 10%, to \$96.6 million for the six months ended June 30, 2012, compared with \$87.7 million for the six months ended June 30, 2011. Approximately \$7.9 million of the increase was representative of OPENLANE's depreciation and amortization in the first six months of 2012. The remaining increase was representative of increased amortization resulting from certain assets placed in service during 2011 and 2012.

Interest Expense

Interest expense decreased \$23.0 million, or 28%, to \$59.9 million for the six months ended June 30, 2012, compared with interest expense of \$82.9 million for the six months ended June 30, 2011. The decrease in interest expense was primarily representative of \$14.5 million in interest expense incurred in the second quarter of 2011 in connection with the settlement and termination of our \$650 million notional swap agreement. In addition, interest expense decreased as a result of the second quarter 2011 prepayment of our \$450.0 million principal amount 8³/₄% senior notes and the remaining \$131.1 million principal balance of our 10% senior subordinated notes, partially offset by Term Loan B debt which had an interest rate of 5% at June 30, 2012, compared with Old Term Loan B debt which had an interest rate of approximately 3% until its prepayment in May 2011. The decrease in interest expense was also partially offset by an increase in interest expense at AFC, which resulted from an increase in the average U.S. portfolio sold in 2012 as compared with 2011, as well as an increase in the cost of funds, which began in the second quarter of 2011.

Other (Income) Expense

We had other income of \$0.4 million for the six months ended June 30, 2012, compared with \$7.3 million for the six months ended June 30, 2011. The change in other income was primarily representative of \$5.9 million of contingent consideration that was reversed in the second quarter of 2011 and \$1.0 million of contingent consideration recorded in 2012. The contingent consideration related to certain prior year acquisitions and the adjustments were based on revised forecasts which indicated the unit volumes required during the measurement period in order for the contingent consideration to become payable would or would not be met.

Loss on Extinguishment of Debt

In May 2011, we terminated our previous credit facility, entered into as of April 20, 2007. In addition, in June 2011, we prepaid \$450.0 million principal amount of the 8³/₄% senior notes and the remaining \$131.1 million principal balance of the 10% senior subordinated notes with proceeds received from Term Loan B and cash on hand. In the second quarter of 2011, we recorded a \$24.5 million pretax charge representative of the write-off of certain unamortized debt issuance costs associated with our Old Term Loan B. In the second quarter of 2011, we also recorded a \$29.0 million pretax charge representative of the net premiums payable related to the repurchase of the 8³/₄% senior notes and the 10% senior subordinated notes, the write-off of certain unamortized debt issuance costs associated with these notes, as well as certain expenses related to the prepayment of these notes.

Income Taxes

We had an effective tax rate of 43.6% for the six months ended June 30, 2012, compared with a tax benefit of 30.1% for the six months ended June 30, 2011. Excluding the effect of the discrete items in the first six months of 2012, our effective tax rate for the six months ended June 30, 2012 would

Table of Contents

have been 41.7%. During the first six months of 2011, our effective tax rate of 30.1% benefited from the reversal of \$14.4 million in reserves for uncertain tax positions due to the expiration of certain statutes of limitations. Excluding the effect of the discrete items in the first six months of 2011, our effective tax rate for the six months ended June 30, 2011 would have been 43.9%. Income before income taxes includes the impact of \$7.0 million and \$10.4 million in profit interest expense for the six months ended June 30, 2012 and 2011, respectively, which is not deductible by us for income tax purposes.

ADESA Results

(Dollars in millions)	Six Months Ended June 30,	
	2012	2011
ADESA revenue	\$ 534.4	\$ 525.8
Cost of services*	295.4	298.7
Gross profit*	239.0	227.1
Selling, general and administrative	128.0	107.5
Depreciation and amortization	50.1	42.4
Operating profit	\$ 60.9	\$ 77.2

*

Exclusive of depreciation and amortization

Revenue

Revenue from ADESA increased \$8.6 million, or 2%, to \$534.4 million for the six months ended June 30, 2012, compared with \$525.8 million for the six months ended June 30, 2011. The increase in revenue was primarily a result of a 10% increase in the number of vehicles sold, partially offset by an 8% decrease in revenue per vehicle sold to over \$545 for the six months ended June 30, 2012, compared to over \$590 for the six months ended June 30, 2011. OPENLANE accounted for approximately \$42.6 million of ADESA's revenue for the six months ended June 30, 2012.

The 8% decrease in revenue per vehicle sold was attributable to lower revenue per vehicle sold at OPENLANE. In addition, decreases in ancillary and related services resulted in decreased ADESA revenue of approximately \$16.0 million, as well as fluctuations in the Canadian exchange rate, which resulted in decreased ADESA revenue of approximately \$3.4 million. Partially offsetting the decreases in revenue was incremental fee income related to selective fee increases, which resulted in increased ADESA revenue of approximately \$12.8 million.

The total number of used vehicles sold at ADESA increased 10% for the six months ended June 30, 2012, compared with the six months ended June 30, 2011, and resulted in an increase in ADESA revenue of approximately \$15.2 million. Excluding OPENLANE, the total number of used vehicles sold at ADESA decreased 6% for the six months ended June 30, 2012, compared with the six months ended June 30, 2011. The decrease in same store volume sold was attributable to a decline in supplier inventory levels, partially offset by a 12% (excluding OPENLANE) increase in dealer consignment units sold in the first six months of 2012 compared with the first six months of 2011. Online sales volume for ADESA in the first six months of 2012 represented approximately 31% of the total vehicles sold by ADESA, which reflects the OPENLANE acquisition, compared with approximately 23% in the first six months of 2011.

The used vehicle conversion percentage, calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale at our ADESA auctions, decreased to 59.0% (excluding OPENLANE) for the six months ended June 30, 2012, compared with 63.7% for the six months ended

Table of Contents

June 30, 2011. The decrease in conversion rate is representative of a change in the mix of vehicles sold toward more dealer consignment vehicles, which convert at a lower rate, as dealers have the option of returning vehicles to their stores for retail sale or utilizing alternative wholesale channels. For the six months ended June 30, 2012, dealer consignment vehicles represented approximately 42% of used vehicles sold at ADESA, an increase from approximately 40% for the six months ended June 30, 2011.

Gross Profit

For the six months ended June 30, 2012, gross profit for ADESA increased \$11.9 million, or 5%, to \$239.0 million, compared with \$227.1 million for the six months ended June 30, 2011. Gross profit for ADESA was 44.7% of revenue for the six months ended June 30, 2012, compared with 43.2% of revenue for the six months ended June 30, 2011. The increase in gross profit as a percentage of revenue for the six months ended June 30, 2012, compared with the six months ended June 30, 2011 was primarily the result of the 10% increase in the number of vehicles sold and a 1% decrease in cost of services. The decrease in cost of services was attributable to decreases in ancillary and related services as well as favorable weather, partially offset by an increase in cost of services attributable to the acquisition of OPENLANE.

Selling, General and Administrative

Selling, general and administrative expenses for the ADESA segment increased \$20.5 million, or 19%, to \$128.0 million for the six months ended June 30, 2012, compared with \$107.5 million for the six months ended June 30, 2011, primarily due to the acquisition and integration of OPENLANE, which accounted for approximately \$20.7 million of the increase, as well as an increase in incentive compensation and professional fees, partially offset by decreases in compensation expense, stock-based compensation expense and fluctuations in the Canadian exchange rate.

IAA Results

(Dollars in millions)	Six Months Ended June 30,	
	2012	2011
IAA revenue	\$ 366.7	\$ 349.1
Cost of services*	216.8	201.4
Gross profit*	149.9	147.7
Selling, general and administrative	37.9	39.6
Depreciation and amortization	33.7	32.5
Operating profit	\$ 78.3	\$ 75.6

*
Exclusive of depreciation and amortization

Revenue

Revenue from IAA increased \$17.6 million, or 5%, to \$366.7 million for the six months ended June 30, 2012, compared with \$349.1 million for the six months ended June 30, 2011. The increase in revenue was a result of an increase in overall vehicles sold of approximately 5% for the six months ended June 30, 2012. Included in the growth of units sold is an increase in the sale of vehicles sold under purchase agreements, in which the entire selling price of the vehicle is recorded as revenue. Vehicles sold under purchase agreements represented approximately 7% of total salvage vehicles sold for the six months ended June 30, 2012. Online sales volumes for IAA for the six months ended June 30, 2012 and 2011 represented approximately half of the total vehicles sold by IAA.

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Gross Profit

For the six months ended June 30, 2012, gross profit at IAA increased to \$149.9 million, or 40.9% of revenue, compared with \$147.7 million, or 42.3% of revenue, for the six months ended June 30, 2011. The gross profit increase was primarily the result of the 5% increase in revenue. The decrease in gross profit as a percentage of revenue was attributable to increases in yard and auction expenses specifically pertaining to reconditioning, processing and towing costs related to the increase in volume, as well as the impact of an increase in vehicles sold under purchase agreements, as the cost of the vehicles are included in the cost of services.

Selling, General and Administrative

Selling, general and administrative expenses at IAA decreased \$1.7 million, or 4%, to \$37.9 million for the six months ended June 30, 2012, compared with \$39.6 million for the six months ended June 30, 2011. The decrease in selling, general and administrative expenses was attributable to decreases in stock-based compensation expense and incentive-based compensation expense.

AFC Results

(Dollars in millions except volumes and per loan amounts)	Six Months Ended June 30,	
	2012	2011
AFC revenue		
Interest and fee income	\$ 92.9	\$ 79.2
Other revenue	5.3	5.8
Provision for credit losses	(4.5)	(2.5)
Total AFC revenue	93.7	82.5
Cost of services*	20.4	18.8
Gross profit*	73.3	63.7
Selling, general and administrative	11.1	10.6
Depreciation and amortization	11.9	12.4
Operating profit	\$ 50.3	\$ 40.7
Loan transactions	611,813	523,743
Revenue per loan transaction	\$ 153	\$ 158

*

Exclusive of depreciation and amortization

Revenue

For the six months ended June 30, 2012, AFC revenue increased \$11.2 million, or 14%, to \$93.7 million, compared with \$82.5 million for the six months ended June 30, 2011. The increase in revenue was the result of a 17% increase in loan transactions to 611,813 for the six months ended June 30, 2012, compared with the same period in 2011, partially offset by a 3% decrease in revenue per loan transaction for the six months ended June 30, 2012. In addition, managed receivables increased to \$935.5 million at June 30, 2012 from \$789.5 million at June 30, 2011.

Revenue per loan transaction, which includes both loans paid off and loans curtailed, decreased primarily as a result of an increase in the provision for credit losses and a decrease in average loan values, partially offset by an increase in the average portfolio duration.

Table of Contents*Gross Profit*

For the six months ended June 30, 2012, gross profit for the AFC segment increased \$9.6 million, or 15%, to \$73.3 million, compared with \$63.7 million for the six months ended June 30, 2011, primarily as a result of a 14% increase in revenue, partially offset by a 9% increase in cost of services. The increase in cost of services was primarily the result of an increase in compensation expense associated with an increase in the number of employees.

Selling, General and Administrative Expenses

Selling, general and administrative expenses at AFC increased \$0.5 million, or 5%, for the six months ended June 30, 2012, compared with the six months ended June 30, 2011. The increase was primarily the result of increases in compensation expense, incentive-based compensation expense and travel costs, partially offset by a decrease in professional fees.

Holding Company Results

(Dollars in millions)	Six Months Ended June 30,	
	2012	2011
Selling, general and administrative	\$ 40.6	\$ 44.4
Depreciation and amortization	0.9	0.4
Operating loss	\$ (41.5)	\$ (44.8)

Selling, General and Administrative Expenses

For the six months ended June 30, 2012, selling, general and administrative expenses at the holding company decreased \$3.8 million, or 9%, to \$40.6 million, compared with \$44.4 million for the six months ended June 30, 2011, primarily as a result of a decrease in stock-based compensation expense, partially offset by an increase in professional fees and OPENLANE integration costs.

LIQUIDITY AND CAPITAL RESOURCES

We believe that the significant indicators of liquidity for our business are cash on hand, cash flow from operations, working capital and amounts available under our credit facility. Our principal sources of liquidity consist of cash generated by operations and borrowings under our revolving credit facility.

(Dollars in millions)	June 30, 2012	December 31, 2011	June 30, 2011
Cash and cash equivalents	\$ 117.1	\$ 97.4	\$ 200.3
Restricted cash	9.3	8.2	6.8
Working capital	274.9	177.0	286.6
Amounts available under credit facility*	250.0	181.1	250.0
Cash flow from operations	170.3		157.5

*

There were related outstanding letters of credit totaling approximately \$23.8 million, \$28.5 million and \$29.6 million at June 30, 2012, December 31, 2011 and June 30, 2011, respectively, which reduced the amount available for borrowings under the credit facility.

Working Capital

A substantial amount of our working capital is generated from the payments received for services provided. The majority of our working capital needs are short-term in nature, usually less than a week

Table of Contents

in duration. Due to the decentralized nature of the business, payments for most vehicles purchased are received at each auction and branch. Most of the financial institutions place a temporary hold on the availability of the funds deposited that generally can range up to two business days, resulting in cash in our accounts and on our balance sheet that is unavailable for use until it is made available by the various financial institutions. There are outstanding checks (book overdrafts) to sellers and vendors included in current liabilities. Because a portion of these outstanding checks for operations in the U.S. are drawn upon bank accounts at financial institutions other than the financial institutions that hold the cash, we cannot offset all the cash and the outstanding checks on our balance sheet.

Our available cash, which excludes cash in transit, was \$83.9 million at June 30, 2012. Of this amount, approximately \$43.5 million was held by foreign subsidiaries and considered to be permanently reinvested in our non-U.S. businesses. If the funds held by our foreign subsidiaries were to be repatriated, tax expense would need to be accrued at the U.S. statutory rate, net of any applicable foreign tax credits. Such foreign tax credits would substantially offset any U.S. taxes that would be due in the event cash held by our foreign subsidiaries was repatriated.

AFC offers short-term inventory-secured financing, also known as floorplan financing, to used vehicle dealers. Financing is primarily provided for terms of 30 to 60 days. AFC principally generates its funding through the sale of its receivables. The receivables sold pursuant to the securitization agreements are accounted for as secured borrowings. For further discussion of AFC's securitization arrangements, see "Securitization Facilities."

Credit Facilities

On May 19, 2011, we established a \$1.7 billion, six-year senior secured term loan facility ("Term Loan B") and a \$250 million, five-year senior secured revolving credit facility, the terms of which are set forth in the Credit Agreement dated as of May 19, 2011 (the "Credit Agreement"). The credit facility is available for letters of credit, working capital and general corporate purposes (including refinancing certain Existing Indebtedness, as defined in the Credit Agreement). The Company pays a commitment fee of 50 basis points, payable quarterly, on the average daily unused amount of the credit facility. The interest rate on Term Loan B was 5.0% at June 30, 2012.

On June 30, 2012, \$1,683.0 million was outstanding on Term Loan B and there were no borrowings on the revolving credit facility. In addition, there were related outstanding letters of credit in the aggregate amount of \$23.8 million at June 30, 2012, which reduce the amount available for borrowings under the credit facility. Our Canadian operations also have a C\$8 million line of credit which was undrawn as of June 30, 2012. However, there were related letters of credit outstanding totaling approximately C\$2.2 million at June 30, 2012, which reduce credit available under the Canadian line of credit, but do not affect amounts available for borrowings under our revolving credit facility.

The Credit Agreement contains certain restrictive loan covenants, including, among others, a financial covenant requiring that a maximum consolidated senior secured leverage ratio be satisfied as of the last day of each fiscal quarter if revolving loans are outstanding, and covenants limiting our ability to incur indebtedness, grant liens, make acquisitions, consummate change of control transactions, dispose of assets, pay dividends, make capital expenditures, make investments and engage in certain transactions with affiliates. The leverage ratio covenant is based on consolidated Adjusted EBITDA which is EBITDA (earnings before interest expense, income taxes, depreciation and amortization) adjusted to exclude among other things (a) gains and losses from asset sales; (b) unrealized foreign currency translation gains and losses in respect of indebtedness; (c) certain non-recurring gains and losses; (d) stock option expense; (e) certain other noncash amounts included in the determination of net income; (f) management, monitoring, consulting and advisory fees paid to the equity sponsors; (g) charges and revenue reductions resulting from purchase accounting; (h) unrealized gains and losses on hedge agreements; (i) minority interest; (j) expenses associated with the consolidation of salvage

Table of Contents

operations; (k) consulting expenses incurred for cost reduction, operating restructuring and business improvement efforts; (l) expenses realized upon the termination of employees and the termination or cancellation of leases, software licenses or other contracts in connection with the operational restructuring and business improvement efforts; (m) expenses incurred in connection with permitted acquisitions; and (n) any impairment charges or write-offs of intangibles.

Certain covenants contained within the Credit Agreement are critical to an investor's understanding of our financial liquidity, as the failure to maintain compliance with these covenants could result in a default and allow our lenders to declare all amounts borrowed immediately due and payable. The maximum consolidated senior secured leverage ratio is required to be met when there are revolving loans outstanding under our Credit Agreement. The maximum consolidated senior secured leverage ratio cannot exceed 4.25 to 1.0 as of the last day of any fiscal quarter through September 30, 2012. Beginning with the quarter ending December 31, 2012, the ratio cannot exceed 4.0 to 1.0 and continues to decline throughout the remaining life of the credit facility until it reaches 2.5 to 1.0 at December 31, 2015. Our actual consolidated senior secured leverage ratio was 3.3 to 1.0 at June 30, 2012.

In addition, the indenture governing our floating rate senior notes contains certain financial and operational restrictions that, similar to the Credit Agreement, limit our ability to pay dividends and other distributions, make certain acquisitions or investments, incur indebtedness, grant liens and sell assets. The covenants in the Credit Agreement and the indenture governing our floating rate senior notes affect our operating flexibility by, among other things, restricting our ability to incur expenses and indebtedness that could be used to grow the business, as well as to fund general corporate purposes. We were in compliance with the covenants in the Credit Agreement and the indenture governing our floating rate senior notes at June 30, 2012.

We believe our sources of liquidity from our cash and cash equivalents on hand, working capital, cash provided by operating activities, and availability under our credit facility are sufficient to meet our short and long-term operating needs for the foreseeable future. In addition, we believe the previously mentioned sources of liquidity will be sufficient to fund our capital requirements and debt service payments for the next twelve months.

Securitization Facilities

AFC sells the majority of its U.S. dollar denominated finance receivables on a revolving basis and without recourse to a wholly owned, bankruptcy remote, consolidated, special purpose subsidiary ("AFC Funding Corporation"), established for the purpose of purchasing AFC's finance receivables. A securitization agreement allows for the revolving sale by AFC Funding Corporation to a bank conduit facility of undivided interests in certain eligible finance receivables subject to committed liquidity. The agreement expires on June 30, 2014. AFC Funding Corporation had committed liquidity of \$650 million for U.S. finance receivables at June 30, 2012.

We also have an agreement for the securitization of Automotive Finance Canada, Inc.'s ("AFCI") receivables. This securitization facility expires on June 30, 2014. AFCI's committed liquidity is provided through a third party conduit (separate from the U.S. conduit) and was C\$100 million at June 30, 2012. The receivables sold pursuant to both the U.S. and Canadian securitization agreements are accounted for as secured borrowings.

AFC managed total finance receivables of \$935.5 million and \$883.2 million at June 30, 2012 and December 31, 2011, respectively. AFC's allowance for losses was \$9.0 million at June 30, 2012 and December 31, 2011.

As of June 30, 2012 and December 31, 2011, \$928.1 million and \$877.6 million, respectively, of finance receivables and a cash reserve of 1 percent of the obligations collateralized by finance

Table of Contents

receivables served as security for the \$634.1 million and \$610.3 million of obligations collateralized by finance receivables at June 30, 2012 and December 31, 2011, respectively. The amount of the cash reserve depends on circumstances which are set forth in the securitization agreements. After the occurrence of a termination event, as defined in the U.S. securitization agreement, the bank conduit facility may, and could, cause the stock of AFC Funding Corporation to be transferred to the bank conduit facility, though as a practical matter the bank conduit facility would look to the liquidation of the receivables under the transaction documents as their primary remedy.

Proceeds from the revolving sale of receivables to the bank conduit facility are used to fund new loans to customers. AFC, AFC Funding Corporation and AFCI must maintain certain financial covenants including, among others, limits on the amount of debt AFC and AFCI can incur, minimum levels of tangible net worth, and other covenants tied to the performance of the finance receivables portfolio. The securitization agreements also incorporate the financial covenants of our credit facility. At June 30, 2012, we were in compliance with the covenants in the securitization agreements.

EBITDA and Adjusted EBITDA

EBITDA and Adjusted EBITDA, as presented herein, are supplemental measures of our performance that are not required by, or presented in accordance with, generally accepted accounting principles in the United States, or GAAP. They are not measurements of our financial performance under GAAP and should not be considered substitutes for net income (loss) or any other performance measures derived in accordance with GAAP.

EBITDA is defined as net income (loss), plus interest expense net of interest income, income tax provision (benefit), depreciation and amortization. Adjusted EBITDA is EBITDA adjusted for the items of income and expense and expected incremental revenue and cost savings, as described above in the discussion of certain restrictive loan covenants under "Credit Facilities."

Management believes that the inclusion of supplementary adjustments to EBITDA applied in presenting Adjusted EBITDA is appropriate to provide additional information to investors about one of the principal measures of performance used by our creditors. In addition, management uses Adjusted EBITDA to evaluate our performance and to evaluate results relative to incentive compensation targets. EBITDA and Adjusted EBITDA have limitations as analytical tools, and should not be considered in isolation or as a substitute for analysis of the results as reported under GAAP. These measures may not be comparable to similarly titled measures reported by other companies.

The following tables reconcile EBITDA and Adjusted EBITDA to net income (loss) for the periods presented:

(Dollars in millions)	Three Months Ended June 30, 2012				
	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	\$ 7.3	\$ 16.2	\$ 16.2	\$ (15.8)	\$ 23.9
Add back:					
Income taxes	7.7	11.0	9.3	(7.8)	20.2
Interest expense, net of interest income	0.3	0.4	3.7	25.2	29.6
Depreciation and amortization	25.1	16.6	5.8	0.5	48.0
Intercompany	15.3	9.5	(4.4)	(20.4)	
EBITDA	55.7	53.7	30.6	(18.3)	121.7
Adjustments	5.0	0.5	(2.3)	3.2	6.4
Adjusted EBITDA	\$ 60.7	\$ 54.2	\$ 28.3	\$ (15.1)	\$ 128.1

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Three Months Ended June 30, 2011

(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	\$ 17.9	\$ 20.7	\$ 13.1	\$ (66.0)	\$ (14.3)
Add back:					
Income taxes	13.1	12.6	8.1	(40.7)	(6.9)
Interest expense, net of interest income	0.2	0.5	3.0	45.9	49.6
Depreciation and amortization	21.0	16.1	6.2	0.3	43.6
Intercompany	9.5	9.6	(3.6)	(15.5)	
EBITDA	61.7	59.5	26.8	(76.0)	72.0
Adjustments	3.7	(3.6)	(1.6)	61.6	60.1
Adjusted EBITDA	\$ 65.4	\$ 55.9	\$ 25.2	\$ (14.4)	\$ 132.1

Six Months Ended June 30, 2012

(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	\$ 16.3	\$ 34.5	\$ 32.5	\$ (33.4)	\$ 49.9
Add back:					
Income taxes	14.9	23.1	18.9	(18.3)	38.6
Interest expense, net of interest income	0.6	0.8	7.4	51.1	59.9
Depreciation and amortization	50.1	33.7	11.9	0.9	96.6
Intercompany	30.2	19.2	(8.5)	(40.9)	
EBITDA	112.1	111.3	62.2	(40.6)	245.0
Adjustments	10.9	2.5	(4.8)	9.4	18.0
Adjusted EBITDA	\$ 123.0	\$ 113.8	\$ 57.4	\$ (31.2)	\$ 263.0

Six Months Ended June 30, 2011

(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	\$ 43.7	\$ 39.9	\$ 28.1	\$ (86.2)	\$ 25.5
Add back:					
Income taxes	11.0	22.0	14.3	(53.2)	(5.9)
Interest expense, net of interest income	0.4	1.1	5.1	76.2	82.8
Depreciation and amortization	42.4	32.5	12.4	0.4	87.7
Intercompany	22.7	19.2	(6.8)	(35.1)	
EBITDA	120.2	114.7	53.1	(97.9)	190.1
Adjustments	6.9	(1.2)	(3.0)	66.6	69.3
Adjusted EBITDA	\$ 127.1	\$ 113.5	\$ 50.1	\$ (31.3)	\$ 259.4

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Certain of our loan covenant calculations utilize financial results for the most recent four consecutive fiscal quarters. The following table reconciles EBITDA and Adjusted EBITDA to net income (loss) for the periods presented:

(Dollars in millions)	Three Months Ended				Twelve Months Ended
	September 30, 2011	December 31, 2011	March 31, 2012	June 30, 2012	June 30, 2012
Net income (loss)	\$ 32.2	\$ 14.5	\$ 26.0	\$ 23.9	\$ 96.6
Add back:					
Income taxes	14.7	9.0	18.4	20.2	62.3
Interest expense, net of interest income	29.3	30.7	30.3	29.6	119.9
Depreciation and amortization	43.8	48.3	48.6	48.0	188.7
EBITDA	120.0	102.5	123.3	121.7	467.5
Nonrecurring charges	5.8	5.2	5.4	3.2	19.6
Noncash charges	(7.5)	7.1	9.1	6.1	14.8
AFC interest expense	(2.6)	(2.7)	(2.9)	(2.9)	(11.1)
Adjusted EBITDA	\$ 115.7	\$ 112.1	\$ 134.9	\$ 128.1	\$ 490.8

Summary of Cash Flows

(Dollars in millions)	Six Months Ended June 30,	
	2012	2011
Net cash provided by (used by):		
Operating activities	\$ 170.3	\$ 157.5
Investing activities	(95.1)	(60.1)
Financing activities	(55.1)	(17.5)
Effect of exchange rate on cash	(0.4)	1.3
Net increase in cash and cash equivalents	\$ 19.7	\$ 81.2

Cash flow from operating activities was \$170.3 million for the six months ended June 30, 2012, compared with \$157.5 million for the six months ended June 30, 2011. The increase in operating cash flow was primarily impacted by the increase in net income and the changes in operating assets and liabilities for the six months ended June 30, 2012, compared with the six months ended June 30, 2011.

Net cash used by investing activities was \$95.1 million for the six months ended June 30, 2012, compared with \$60.1 million for the six months ended June 30, 2011. The increase in net cash used by investing activities was primarily the result of the changes in finance receivables held for investment and changes in restricted cash balances. Partially offsetting the aforementioned activities were lower levels of spending on acquisitions and capital items, as we spent \$3.7 million less on acquisitions and \$2.0 million less on capital items in the first six months of 2012 compared with the same period in 2011. For a discussion of the Company's capital expenditures, see "Capital Expenditures" below.

Net cash used by financing activities was \$55.1 million for the six months ended June 30, 2012, compared with \$17.5 million for the six months ended June 30, 2011. The change in net cash used by financing activities was primarily attributable to the repayment of \$68.9 million that was outstanding on our revolving credit facility, as well as a smaller increase in book overdrafts for the six months ended June 30, 2012, compared with the six months ended June 30, 2011.

Table of Contents

Capital Expenditures

Capital expenditures for the six months ended June 30, 2012 and 2011 approximated \$37.3 million and \$39.3 million, respectively. Capital expenditures were funded primarily from internally generated funds. We continue to invest in our core information technology capabilities and capacity expansion. Capital expenditures are expected to be approximately \$90 million for fiscal year 2012, compared with \$85.8 million for the year ended December 31, 2011. Anticipated expenditures are primarily attributable to ongoing information system projects, integration of OPENLANE and ADESA information systems, upkeep and improvements at existing vehicle auction facilities, improvements in information technology systems and infrastructure and expansion and relocation of existing auction sites that are at capacity. Future capital expenditures could vary substantially based on capital project timing and the initiation of new information systems projects to support our business strategies.

Contractual Obligations

The Company's contractual cash obligations for long-term debt, interest payments related to long-term debt, capital lease obligations, operating leases and postretirement benefit payments were summarized in the table of contractual obligations in our Annual Report on Form 10-K for the year ended December 31, 2011. Since December 31, 2011, there have been no material changes to the contractual obligations of the Company, other than in the first quarter of 2012, in which we repaid the \$68.9 million that was outstanding on our revolving credit facility at December 31, 2011.

See Note 6 to the Consolidated Financial Statements, included elsewhere in this Interim Report on Form 10-Q, for additional information about the item described above. For additional information regarding our contractual cash obligations as of December 31, 2011, see Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed on February 28, 2012.

Critical Accounting Estimates

Our critical accounting estimates are discussed in the "Critical Accounting Estimates" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the Securities and Exchange Commission. In addition, our most significant accounting policies are discussed in Note 2 and elsewhere in the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2011, which includes audited financial statements.

New Accounting Standards

In June 2011, the FASB issued ASU 2011-05, *Comprehensive Income (Topic 220) Presentation of Comprehensive Income*. The new guidance requires an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income, either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. In December 2011, the FASB issued ASU 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in ASU 2011-05*, to defer the effective date of the specific requirement to present items that are reclassified out of accumulated other comprehensive income to net income alongside their respective components of net income and other comprehensive income. All other provisions of ASU 2011-05 are effective for the first annual reporting period, and interim periods within those years, beginning after December 15, 2011, and should be applied retrospectively. The adoption of ASU 2011-05 did not have a material impact on the consolidated financial statements and

Table of Contents

we do not expect the adoption of ASU 2011-12 will have a material impact on the consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency

Our foreign currency exposure is limited and arises from transactions denominated in foreign currencies, particularly intercompany loans, as well as from translation of the results of operations from our Canadian and, to a much lesser extent, Mexican subsidiaries. However, fluctuations between U.S. and non-U.S. currency values may adversely affect our results of operations and financial position. We have not entered into any foreign exchange contracts to hedge changes in the Canadian or Mexican exchange rates. Canadian currency translation negatively affected net income by approximately \$0.6 million and \$0.7 million for the three and six months ended June 30, 2012, respectively. Currency exposure of our Mexican operations is not material to the results of operations.

Interest Rates

We are exposed to interest rate risk on our variable rate borrowings. Accordingly, interest rate fluctuations affect the amount of interest expense we are obligated to pay. We use interest rate derivative agreements to manage the variability of cash flows to be paid due to interest rate movements on our variable rate debt. We have designated our interest rate derivatives as cash flow hedges. The earnings impact of the derivatives designated as cash flow hedges are recorded upon the recognition of the interest related to the hedged debt. Any ineffectiveness in the hedging relationships is recognized in current earnings. There was no significant ineffectiveness in the six months ended June 30, 2012 or 2011.

In August 2011, we purchased three interest rate caps for an aggregate amount of approximately \$1.1 million with an aggregate notional amount of \$925 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility when one-month LIBOR exceeds 1.25%. The interest rate cap agreements each had an effective date of August 16, 2011 and each mature on August 16, 2013.

A sensitivity analysis of the impact on our variable rate debt instruments to a hypothetical 100 basis point increase in short-term rates for the three and six months ended June 30, 2012 would have resulted in an increase in interest expense of approximately \$0.4 million and \$1.1 million, respectively.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting during the quarter ended June 30, 2012, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

**PART II
OTHER INFORMATION**

Item 1. Legal Proceedings

We are involved in litigation and disputes arising in the ordinary course of business, such as actions related to injuries; property damage; handling, storage or disposal of vehicles; environmental laws and regulations; and other litigation incidental to the business such as employment matters and dealer disputes. Such litigation is generally not, in the opinion of management, likely to have a material adverse effect on our financial condition, results of operations or cash flows. Legal and regulatory proceedings which could be material are discussed below.

Certain legal proceedings in which the Company is involved are discussed in Note 16 to the consolidated financial statements in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2011 and Part I, Item 3 of the same Annual Report. The following discussion is limited to certain recent developments concerning our legal and regulatory proceedings and should be read in conjunction with the Annual Report. Unless otherwise indicated, all proceedings discussed in the Annual Report remain outstanding.

IAA Lower Duwamish Waterway

On March 25, 2008, the United States Environmental Protection Agency, or EPA, issued a General Notice of Potential Liability (the "General Notice") pursuant to Section 107(a), and a Request for Information pursuant to Section 104(e) of the Comprehensive Environmental Response, Compensation, and Liability Act, or "CERCLA" to IAA for a Superfund site known as the Lower Duwamish Waterway ("LDW") Superfund Site in Seattle, Washington. IAA operates a branch on property it leases in Tukwila, Washington, which is located adjacent to the LDW. At this time, the EPA has not demanded that IAA pay any funds or take any action apart from responding to the Section 104(e) Information Request. The EPA has advised IAA that, to date, it has sent out approximately 60 general notice letters to other parties, and has sent Section 104(e) Requests to more than 250 other parties. A remedial investigation has been conducted for this site by some of the potentially responsible parties, who have also commenced a feasibility study pursuant to CERCLA. IAA is aware that certain authorities plan to bring Natural Resource Damage claims against potentially responsible parties. In the General Notice, the EPA informed IAA that it may be a potentially responsible party based on presently available information. At this time, the Company does not have adequate information to determine IAA's responsibility for contamination at this site, if any, or to estimate IAA's loss as a result of this potential liability.

In addition, the Washington State Department of Ecology is working with the EPA in relation to the LDW, primarily to investigate and address sources of potential contamination contributing to the LDW. IAA, the current Tukwila property owner and the former Tukwila property owner are currently in discussion with the Washington State Department of Ecology concerning possible source control obligations, including an investigation of the water and soils entering the stormwater system, an analysis of the source of any contamination identified within the system and possible repairs and upgrades to the stormwater capture and filtration system. In 2011, IAA submitted results of its stormwater system investigation to comply with the Washington State Department of Ecology source control requirements. Additional source control obligations, if any, are not expected to have a material impact on future recurring operating costs.

IAA Carteret

In November 2011, the Borough of Carteret, New Jersey ("Carteret"), sued Insurance Auto Auctions Corp. ("IAA") seeking injunctive relief, statutory fines and other damages, alleging violations of state and local laws prohibiting the release of contaminants onto the lands and into the waters of

Table of Contents

New Jersey and Carteret. Carteret alleges that its investigator observed leaking vehicles, soil staining and water runoff at IAA's Carteret, New Jersey, facility during a period from August 2011 through September 2011 that had the potential to enter the municipal sewer system. IAA denies Carteret's allegations. The case is pending in the Superior Court of New Jersey, Middlesex County, Chancery Division under Case number MID-C-234-11. The ultimate outcome of this litigation is not expected to have a material adverse effect upon the Company's operations, financial condition or financial statements taken as a whole.

Item 1A. Risk Factors

In addition to the other information set forth in this report, readers should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 4. Mine Safety Disclosures

Not applicable.

Item 6. Exhibits

a)

Exhibits the exhibit list in the Exhibit Index is incorporated herein by reference as the list of exhibits required as part of this report.

In reviewing the agreements included as exhibits to this Form 10-Q, please remember they are included to provide you with information regarding their terms and are not intended to provide any other factual or disclosure information about KAR Auction Services, ADESA, IAA or other parties to the agreements.

The agreements included or incorporated by reference as exhibits to this Quarterly Report on Form 10-Q contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties were made solely for the benefit of the other parties to the applicable agreement and (i) were not intended to be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate; (ii) may have been qualified in such agreement by disclosures that were made to the other party in connection with the negotiation of the applicable agreement; (iii) may apply contract standards of "materiality" that are different from "materiality" under the applicable securities laws; and (iv) were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement.

The Company acknowledges that, notwithstanding the inclusion of the foregoing cautionary statements, it is responsible for considering whether additional specific disclosures of material information regarding material contractual provisions are required to make the statements in this Quarterly Report on Form 10-Q not misleading. Additional information about KAR Auction Services may be found elsewhere in this Quarterly Report on Form 10-Q and KAR Auction Services' other public filings, which are available without charge through the SEC's website at <http://www.sec.gov>.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 7, 2012

KAR Auction Services, Inc.
(Registrant)
/s/ ERIC M. LOUGHMILLER

Eric M. Loughmiller
*Executive Vice President and Chief Financial Officer (Duly Authorized
Officer and Principal Financial and Accounting Officer)*

62

Table of Contents**EXHIBIT INDEX**

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
3.1	Amended and Restated Certificate of Incorporation of KAR Auction Services, Inc.	S-1/A	333-161907	3.1	12/10/2009	
3.2	Amended and Restated By-Laws of KAR Auction Services, Inc.	S-1/A	333-161907	3.2	12/10/2009	
4.1	Indenture, dated April 20, 2007 (the "Floating Senior Indenture"), among KAR Auction Services, Inc. (formerly KAR Holdings, Inc.), the guarantors from time to time parties thereto and Wells Fargo Bank, National Association, as Trustee, for \$150,000,000 Floating Rate Senior Notes due 2014	S-4	333-148847	4.1	1/25/2008	
4.2	Form of common stock certificate	S-1/A	333-161907	4.15	12/10/2009	
10.1	Credit Agreement, dated May 19, 2011, among KAR Auction Services, Inc., as borrower, the lenders party thereto, JPMorgan Chase Bank, N.A., as administrative agent, J.P. Morgan Securities LLC, as sole lead arranger, J.P. Morgan Securities LLC, Goldman Sachs Lending Partners LLC, Barclays Capital and Deutsche Bank Securities Inc., as joint bookrunners, Goldman Sachs Lending Partners LLC, as syndication agent, and Barclays Bank PLC and Deutsche Bank Securities Inc., as co-documentation agents	10-Q	001-34568	10.1	8/9/2011	
10.2	Guarantee and Collateral Agreement, dated May 19, 2011, made by KAR Auction Services, Inc. and certain of its Subsidiaries in favor of JPMorgan Chase Bank, N.A., as administrative agent under the Credit Agreement	10-Q	001-34568	10.2	8/9/2011	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.3	Intellectual Property Security Agreement, dated May 19, 2011, made by KAR Auction Services, Inc., ADESA, Inc., Automotive Finance Corporation, Automotive Finance Consumer Division, LLC and Insurance Auto Auctions, Inc., in favor of JPMorgan Chase Bank, N.A., as administrative agent for the secured parties (as defined in the Credit Agreement)	10-Q	001-34568	10.3	8/9/2011	
10.4*	Letter Agreement, dated February 24, 2010, between KAR LLC and Thomas C. O'Brien, David R. Montgomery, Donald J. Hermanek, Scott P. Pettit, John Kett, John Nordin and Sidney Kerley	10-K	001-34568	10.5	2/25/2010	
10.5*	Conversion Option Plan of KAR Auction Services, Inc. (formerly KAR Holdings, Inc.)	S-1/A	333-158666	10.9	6/17/2009	
10.6a*	Form of Conversion Stock Option Agreement, dated April 20, 2007, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and each of Thomas C. O'Brien, David R. Montgomery, Donald J. Hermanek, Scott P. Pettit, John Kett, John Nordin and Sidney Kerley	S-4	333-148847	10.10	1/25/2008	
10.6b*	Form of Amendment to Conversion Stock Option Agreement, dated October 30, 2007, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and each of Thomas C. O'Brien, David R. Montgomery, Donald J. Hermanek and Scott P. Pettit	S-4	333-148847	10.11	1/25/2008	
10.6c*	Form of Amendment to Conversion Stock Option Agreements, dated February 19, 2009, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and each of Thomas C. O'Brien, David R. Montgomery, Donald J. Hermanek and Scott P. Pettit	10-K	333-148847	10.10	3/11/2009	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.7*	Form of Rollover Stock Option Agreement, dated April 20, 2007, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and certain executive officers and employees of IAA	S-4	333-148847	10.12	1/25/2008	
10.8*	Form of Conversion Agreement, dated April 20, 2007, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and certain executive officers and employees of IAA	S-1/A	333-158666	10.13	6/17/2009	
10.9*	KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) Stock Incentive Plan	S-8	333-164032	10.1	12/24/2009	
10.10*	Form of Nonqualified Stock Option Agreement of KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) pursuant to the Stock Incentive Plan	S-4	333-148847	10.15	1/25/2008	
10.11*	Severance, Release and Waiver Agreement, dated February 18, 2011, between KAR Auction Services, Inc. and John Nordin	10-K	001-34568	10.12c	2/24/2011	
10.12*	Letter Agreement dated December 3, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.), Automotive Finance Corporation and Donald S. Gottwald	10-K	001-34568	10.15	2/25/2010	
10.13a*	Amended and Restated Employment Agreement, dated April 2, 2001, between Thomas C. O'Brien and Insurance Auto Auctions, Inc.	S-4	333-148847	10.22	1/25/2008	
10.13b*	Amendment to Amended and Restated Employment Agreement, dated December 1, 2008, between Thomas C. O'Brien and Insurance Auto Auctions, Inc.	10-K	333-148847	10.31	3/11/2009	
10.14*	Severance and Consulting Agreement, dated August 15, 2011, between Peter Kelly and ADESA, Inc.	10-K	001-34568	10.14	2/28/2012	
10.15*	Employment Agreement, dated February 27, 2012, between KAR Auction Services, Inc. and James P. Hallett	10-K	001-34568	10.15	2/28/2012	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.16a^	Second Amended and Restated Limited Liability Company Agreement of KAR Holdings II, LLC, dated April 20, 2007	S-1/A	333-158666	10.23	7/2/2009	
10.16b	First Amendment to Second Amended and Restated Limited Liability Company Agreement of KAR Holdings II, LLC, dated December 10, 2009	10-K	001-34568	10.16b	2/28/2012	
10.16c	Second Amendment to Second Amended and Restated Limited Liability Company Agreement of KAR Holdings II, LLC, dated December 15, 2009	10-K	001-34568	10.16c	2/28/2012	
10.16d	Third Amendment to Second Amended and Restated Limited Liability Company Agreement of KAR Holdings II, LLC, dated February 27, 2012	10-K	001-34568	10.16d	2/28/2012	
10.17a	Amended and Restated Limited Liability Company Agreement of Axle Holdings II, LLC, dated May 25, 2005	S-1/A	333-158666	10.24	6/17/2009	
10.17b	Amendment to the Amended and Restated Limited Liability Company Agreement of Axle Holdings II, LLC, dated November 2, 2006	S-4	333-148847	10.25	1/25/2008	
10.17c	First Amendment to the Amended and Restated Limited Liability Company Agreement of Axle Holdings II, LLC, dated April 20, 2007	S-4	333-148847	10.26	1/25/2008	
10.18*	KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) Annual Incentive Program	10-K	333-148847	10.29	3/11/2009	
10.19a^	Amended and Restated Purchase and Sale Agreement, dated May 31, 2002, between AFC Funding Corporation and Automotive Finance Corporation	S-4	333-148847	10.32	1/25/2008	
10.19b	Amendment No. 1 to Amended and Restated Purchase and Sale Agreement, dated June 15, 2004	S-4	333-148847	10.33	1/25/2008	
10.19c	Amendment No. 2 to Amended and Restated Purchase and Sale Agreement, dated January 18, 2007	S-4	333-148847	10.34	1/25/2008	
10.19d^	Amendment No. 3 to Amended and Restated Purchase and Sale Agreement, dated April 20, 2007	S-4	333-148847	10.35	1/25/2008	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.19e	Amendment No. 4 to Amended and Restated Purchase and Sale Agreement, dated January 30, 2009	10-K	001-34568	10.19e	2/28/2012	
10.19f	Amendment No. 5 to Amended and Restated Purchase and Sale Agreement, dated April 25, 2011	10-K	001-34568	10.19f	2/28/2012	
10.20a^	Fourth Amended and Restated Receivables Purchase Agreement, dated April 26, 2011, among AFC Funding Corporation, Automotive Finance Corporation, Fairway Finance Company, LLC, Monterey Funding LLC, Salisbury Receivables Company LLC, Deutsche Bank AG, New York Branch, Barclays Bank PLC and BMO Capital Markets Corp.	10-Q/A	001-34568	10.20	1/17/2012	
10.20b	Amendment No. 1 to Fourth Amended and Restated Receivables Purchase Agreement, dated May 20, 2011	10-K	001-34568	10.20b	2/28/2012	
10.20c^	Amendment No. 2 to Fourth Amended and Restated Receivables Purchase Agreement, dated October 12, 2011	10-K	001-34568	10.20c	2/28/2012	
10.20d^	Amendment No. 3 to Fourth Amended and Restated Receivables Purchase Agreement, dated April 2, 2012					X
10.21^	Amended and Restated Receivables Purchase Agreement, dated May 24, 2011, among KAR Auction Services, Inc., Automotive Finance Canada Inc. and BNY Trust Company of Canada	10-Q/A	001-34568	10.22	1/17/2012	
10.22a	Ground Lease, dated September 4, 2008, between ADESA San Diego, LLC and First Industrial L.P. (East 39 Acres at Otay Mesa, California)	8-K	333-148847	10.3	9/9/2008	
10.22b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial L.P. (East 39 Acres at Otay Mesa, California)	8-K	333-148847	10.11	9/9/2008	
10.23a	Ground Lease, dated September 4, 2008, between ADESA San Diego, LLC and First Industrial L.P. (West 39 Acres at Otay Mesa, California)	8-K	333-148847	10.4	9/9/2008	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.23b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial L.P. (West 39 Acres at Otay Mesa, California)	8-K	333-148847	10.12	9/9/2008	
10.24a	Ground Lease, dated September 4, 2008, between ADESA California, LLC and ADESA San Diego, LLC and First Industrial Pennsylvania, L.P. (Sacramento, California)	8-K	333-148847	10.5	9/9/2008	
10.24b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial Pennsylvania, L.P. (Sacramento, California)	8-K	333-148847	10.13	9/9/2008	
10.25a	Ground Lease, dated September 4, 2008, between ADESA California, LLC and First Industrial Pennsylvania, L.P. (Tracy, California)	8-K	333-148847	10.6	9/9/2008	
10.25b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial Pennsylvania, L.P. (Tracy, California)	8-K	333-148847	10.14	9/9/2008	
10.26a	Ground Lease, dated September 4, 2008, between ADESA Washington, LLC and First Industrial, L.P. (Auburn, Washington)	8-K	333-148847	10.7	9/9/2008	
10.26b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial, L.P. (Auburn, Washington)	8-K	333-148847	10.15	9/9/2008	
10.27a	Ground Lease, dated September 4, 2008, between ADESA Texas, Inc. and First Industrial, L.P. (Houston, Texas)	8-K	333-148847	10.8	9/9/2008	
10.27b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial, L.P. (Houston, Texas)	8-K	333-148847	10.16	9/9/2008	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.28a	Ground Lease, dated September 4, 2008, between ADESA Florida, LLC and First Industrial Financing Partnership, L.P. (Bradenton, Florida)	8-K	333-148847	10.10	9/9/2008	
10.28b	Guaranty of Lease, dated September 4, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial Financing Partnership, L.P. (Bradenton, Florida)	8-K	333-148847	10.18	9/9/2008	
10.29a	Ground Sublease, dated October 3, 2008, between ADESA Atlanta, LLC and First Industrial, L.P. (Fairburn, Georgia)	10-Q	333-148847	10.21	11/13/2008	
10.29b	Guaranty of Lease, dated October 3, 2008, between KAR Auction Services, Inc. (formerly KAR Holdings, Inc.) and First Industrial, L.P. (Fairburn, Georgia)	10-Q	333-148847	10.22	11/13/2008	
10.30	Director Designation Agreement, dated December 10, 2009, among KAR Auction Services, Inc. (formerly known as KAR Holdings, Inc.) and KAR Holdings II, LLC	10-K	001-34568	10.34	2/24/2011	
10.31*	Form of KAR Auction Services, Inc. 2009 Omnibus Stock and Incentive Plan	S-8	333-164032	10.2	12/24/2009	
10.32a*	Form of KAR Auction Services, Inc. Employee Stock Purchase Plan	S-8	333-164032	10.3	12/24/2009	
10.32b*	Amendment No. 1 to KAR Auction Services, Inc. Employee Stock Purchase Plan dated March 31, 2010	10-Q	001-34568	10.60	8/4/2010	
10.32c*	Amendment No. 2 to KAR Auction Services, Inc. Employee Stock Purchase Plan dated April 1, 2010	10-Q	001-34568	10.61	8/4/2010	
10.33*	KAR Auction Services, Inc. Directors Deferred Compensation Plan, effective December 10, 2009	10-Q	001-34568	10.62	8/4/2010	
10.34*	Form of Director Restricted Share Agreement	10-Q	001-34568	10.63	8/4/2010	
10.35*	Form of Nonqualified Stock Option Agreement	S-1/A	333-161907	10.65	12/4/2009	
10.36*	Form of Restricted Share Agreement	S-1/A	333-161907	10.66	12/4/2009	

Edgar Filing: KAR Auction Services, Inc. - Form 10-Q

Table of Contents

Exhibit No.	Exhibit Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Filing Date	
10.37	Agreement and Plan of Merger dated as of August 15, 2011 by and among ADESA, Inc., Riley Acquisition, Inc., KAR Auction Services, Inc., OPENLANE, Inc. and Shareholder Representative Services LLC, as the securityholders representative	8-K	001-34568	2.1	8/15/2011	
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002					X
32.1	Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
32.2	Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002					X
101.INS**	XBRL Instance Document					X
101.SCH**	XBRL Taxonomy Extension Schema					X
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase					X
101.DEF**	XBRL Taxonomy Extension Definition Linkbase					X
101.LAB**	XBRL Taxonomy Extension Label Linkbase					X
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase					X

^ Portions of this exhibit have been redacted pursuant to a request for confidential treatment filed separately with the Secretary of the Securities and Exchange Commission pursuant to Rule 406 under the Securities Act of 1933, as amended.

* Denotes management contract or compensation plan, contract or arrangement.

** Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed furnished and not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed furnished and not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.