KAR Auction Services, Inc.
Form 10-Q
November 05, 2013
Use these links to rapidly review the document
KAR Auction services, Inc. 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 September 30, 2013
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

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 o	Accelerated filer ý	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of October 31, 2013, 138,830,992 shares of the registrant's common stock, par value $0.01 per share, were outstanding.

KAR Auction Services, Inc.
Table of Contents

		Page
PART I—FINANCIAL INFORMATION		
Item 1.	Financial Statements (Unaudited)	
	Consolidated Statements of Income	2
	Consolidated Statements of Comprehensive Income	3
	Consolidated Balance Sheets	4
	Consolidated Statement of Stockholders' Equity	6
	Consolidated Statements of Cash Flows	7
	Notes to Consolidated Financial Statements	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	40
Item 4.	Controls and Procedures	40
PART II—OTHER INFORMATION		
Item 1.	Legal Proceedings	41
Item 1A.	Risk Factors	42
Item 4.	Mine Safety Disclosures	53
Item 6.	Exhibits	53
Signatures		55
Exhibit Index		56

Table of Contents

PART I
FINANCIAL INFORMATION
Item 1. Financial Statements
KAR Auction Services, Inc.
Consolidated Statements of Income
(In millions, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Operating revenues				
ADESA Auction Services	$275.4	$257.0	$844.3	$791.4
IAA Salvage Services	198.8	167.4	623.2	534.1
AFC	59.5	50.5	165.2	144.2
Total operating revenues	533.7	474.9	1,632.7	1,469.7
Operating expenses				
Cost of services (exclusive of depreciation and amortization)	296.2	264.1	926.5	796.7
Selling, general and administrative	120.3	102.3	333.3	319.9
Depreciation and amortization	49.6	46.8	145.9	143.4
Total operating expenses	466.1	413.2	1,405.7	1,260.0
Operating profit	67.6	61.7	227.0	209.7
Interest expense	26.0	29.9	79.3	89.8
Other income, net	(0.8)	(1.2)	(2.5)	(1.6)
Loss on modification/extinguishment of debt	—	—	5.4	—
Income before income taxes	42.4	33.0	144.8	121.5
Income taxes	19.6	13.8	59.5	52.4
Net income	$22.8	$19.2	$85.3	$69.1
Net income per share				
Basic	$0.16	$0.14	$0.62	$0.51
Diluted	$0.16	$0.14	$0.61	$0.50
Dividends declared per common share	$0.19	$—	$0.57	$—

See accompanying notes to consolidated financial statements

Table of Contents

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$22.8	$19.2	$85.3	$69.1
Other comprehensive income (loss), net of tax				
Foreign currency translation gain (loss)	4.6	8.7	(9.7)	9.8
Unrealized gain (loss) on interest rate derivatives, net of tax of $0 for the three months ended September 30, 2013 and 2012, and $(0.1) and $0.2 for the nine months ended September 30, 2013 and 2012	0.1	—	0.2	(0.4)
Total other comprehensive income (loss), net of tax	4.7	8.7	(9.5)	9.4
Comprehensive income	$27.5	$27.9	$75.8	$78.5

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
Consolidated Balance Sheets
(In millions)
(Unaudited)

	September 30, 2013	December 31, 2012
Assets		
Current assets		
Cash and cash equivalents	$196.0	$108.7
Restricted cash	9.1	11.9
Trade receivables, net of allowances of $4.3 and $5.3	385.4	342.4
Finance receivables, net of allowances $8.0 and $8.0	1,066.0	996.2
Deferred income tax assets	35.2	35.4
Other current assets	91.0	86.8
Total current assets	1,782.7	1,581.4
Other assets		
Goodwill	1,702.2	1,679.6
Customer relationships, net of accumulated amortization of $461.3 and $405.3	582.5	618.9
Other intangible assets, net of accumulated amortization of $207.5 and $168.9	304.4	305.2
Unamortized debt issuance costs	41.1	24.9
Other assets	9.9	11.6
Total other assets	2,640.1	2,640.2
Property and equipment, net of accumulated depreciation of $459.3 and $415.5	699.2	700.7
Total assets	$5,122.0	$4,922.3

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
Consolidated Balance Sheets
(In millions, except share and per share data)
(Unaudited)

	September 30, 2013	December 31, 2012
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	$490.3	$388.4
Accrued employee benefits and compensation expenses	61.4	63.5
Accrued interest	0.3	1.6
Other accrued expenses	98.1	75.8
Income taxes payable	0.8	0.6
Dividends payable	26.3	—
Obligations collateralized by finance receivables	742.4	713.3
Current maturities of long-term debt	—	43.7
Total current liabilities	1,419.6	1,286.9
Non-current liabilities		
Long-term debt	1,770.3	1,774.6
Deferred income tax liabilities	343.0	318.6
Other liabilities	105.2	98.5
Total non-current liabilities	2,218.5	2,191.7
Commitments and contingencies (Note 8)		
Stockholders' equity		
Preferred stock, $0.01 par value: Authorized shares: 100,000,000 Issued shares: none	—	—
Common stock, $0.01 par value: Authorized shares: 400,000,000 Issued and outstanding shares: September 30, 2013: 138,625,706 December 31, 2012: 136,657,645	1.4	1.4
Additional paid-in capital	1,476.8	1,433.9
Accumulated deficit	(19.9)	(26.7)
Accumulated other comprehensive income	25.6	35.1
Total stockholders' equity	1,483.9	1,443.7
Total liabilities and stockholders' equity	$5,122.0	$4,922.3

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
Consolidated Statements of Stockholders' Equity
(In millions)
(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2012	136.7	$1.4	$1,433.9	$(26.7)	$ 35.1	$1,443.7
Net income				85.3		85.3
Other comprehensive loss, net of tax					(9.5)	(9.5)
Issuance of common stock under stock plans	1.9		20.8			20.8
Stock-based compensation expense			16.8			16.8
Excess tax benefits from stock-based compensation			5.3			5.3
Cash dividends declared to stockholders ($0.57 per share)				(78.5)		(78.5)
Balance at September 30, 2013	138.6	$1.4	$1,476.8	$(19.9)	$ 25.6	$1,483.9

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2013	2012
Operating activities		
Net income	$85.3	$69.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	145.9	143.4
Provision for credit losses	7.3	6.8
Deferred income taxes	11.3	(18.6)
Amortization of debt issuance costs	8.0	5.2
Stock-based compensation	16.8	20.9
Contingent consideration adjustment	—	1.0
(Gain) loss on disposal of fixed assets	0.2	(1.7)
Loss on modification/extinguishment of debt	5.4	—
Other non-cash, net	11.1	7.6
Changes in operating assets and liabilities, net of acquisitions:		
Trade receivables and other assets	(21.2)	(95.3)
Accounts payable and accrued expenses	48.3	99.6
Net cash provided by operating activities	318.4	238.0
Investing activities		
Net increase in finance receivables held for investment	(79.6)	(57.4)
Acquisition of businesses, net of cash acquired	(28.8)	(0.5)
Purchases of property, equipment and computer software	(75.3)	(60.8)
Proceeds from the sale of property and equipment	0.2	5.7
Decrease in restricted cash	2.8	0.5
Net cash used by investing activities	(180.7)	(112.5)
Financing activities		
Net increase in book overdrafts	38.6	10.8
Net decrease in borrowings from lines of credit	—	(68.9)
Net increase in obligations collateralized by finance receivables	31.8	20.6
Proceeds from long-term debt	188.0	—
Payments for debt issuance costs/amendments	(26.0)	—
Payments on long-term debt	(49.2)	(12.8)
Payment for early extinguishment of debt	(188.4)	—
Payments on capital leases	(11.4)	(10.6)
Payments of contingent consideration and deferred acquisition costs	(1.6)	(4.2)
Initial net investment for interest rate caps	(2.2)	—
Issuance of common stock under stock plans	20.8	2.8
Excess tax benefits from stock-based compensation	5.3	—
Dividends paid to stockholders	(52.2)	—
Net cash used by financing activities	(46.5)	(62.3)
Effect of exchange rate changes on cash	(3.9)	3.1
Net increase in cash and cash equivalents	87.3	66.3
Cash and cash equivalents at beginning of period	108.7	97.4
Cash and cash equivalents at end of period	$196.0	$163.7

Cash paid for interest	$68.7	$80.9
Cash paid for taxes, net of refunds	$36.6	$44.5

See accompanying notes to consolidated financial statements

7

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements
September 30, 2013 (Unaudited)
Note 1—Basis of Presentation and Nature of Operations
Defined Terms
Unless otherwise indicated or unless the context otherwise requires, the following terms used herein shall have the following meanings:

- "we," "us," "our" and "the Company" refer, collectively, to KAR Auction Services, Inc. and all of its subsidiaries;
- "ADESA" refers, collectively, to ADESA, Inc., a wholly owned subsidiary of KAR Auction Services, and ADESA, Inc.'s subsidiaries, including OPENLANE, Inc. (together with OPENLANE, Inc.'s subsidiaries, "OPENLANE");
- "AFC" refers, collectively, to Automotive Finance Corporation, a wholly owned subsidiary of ADESA, and Automotive Finance Corporation's subsidiaries and other related entities, including PWI Holdings, Inc.;
- "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, as amended on November 29, 2012 and March 12, 2013;
- "Credit Facility" refers to the six year senior secured term loan facility ("Term Loan B") 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.;
- "IAA" refers, collectively, to Insurance Auto Auctions, Inc., a wholly owned subsidiary of KAR Auction Services, and Insurance Auto Auctions, Inc.'s subsidiaries;
- "KAR Auction Services" refers to KAR Auction Services, Inc. and not to its subsidiaries; and
- "KAR LLC" refers to KAR Holdings II, LLC, which is owned by affiliates of the Equity Sponsors, other equity co-investors and management of the Company.

Basis of Presentation
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, generally consisting of normal recurring accruals necessary, for a fair statement of our results of operations, cash flows and financial position for the periods 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, 2012. The 2012 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.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Business and Nature of Operations

As of September 30, 2013, we have a network of 66 ADESA whole car auction sites and 163 IAA salvage vehicle auction sites; in addition, we offer online auctions for both whole car and salvage vehicles. 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. ADESA's online service offerings include customized private label solutions powered with software developed by our wholly owned subsidiary, OPENLANE, that allow our institutional consignors (automobile manufacturers, captive finance companies and other institutions) to offer vehicles via the internet prior to arrival at the physical auction. 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 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 leading providers of salvage vehicle auctions and related services in North America. The salvage auctions facilitate the remarketing of damaged vehicles that are designated as total losses by insurance companies, recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made, purchased vehicles 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 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 is provided through 105 locations throughout the United States and Canada as of September 30, 2013. Floorplan financing supports independent used vehicle dealers in North America who purchase vehicles at ADESA, IAA, other used vehicle and salvage auctions and non-auction purchases.

Note 2—Acquisitions

In June 2013, the Company purchased the stock of PWI Holdings, Inc., whose subsidiary, Preferred Warranties, Inc., markets vehicle service contracts through a network of independent used vehicle dealers. The acquisition is expected to strengthen KAR's product offerings to independent used vehicle dealers. The assets of PWI Holdings, Inc. included accounts receivable, software and customer relationships related to the business. Financial results for this acquisition have been included in our consolidated financial statements from the date of acquisition.

The purchase price of PWI Holdings, Inc., net of cash, was approximately $27.3 million. The acquired assets and liabilities were recorded based upon fair values, including $26.9 million assigned to intangible assets, representing the fair value of acquired customer relationships, tradenames and software, which are being amortized over their respective useful lives. The acquisition resulted in goodwill of $22.7 million which is not expected to be deductible for tax purposes. The goodwill is recorded in the AFC reportable segment. The financial impact of this acquisition was immaterial to the Company's statement of income for the three and nine months ended September 30, 2013.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

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. Through the first nine months of 2013, we granted approximately 0.5 million service options with a weighted average exercise price of $23.24 per share under the Omnibus Plan. The service options have a 10 year life and generally vest in four equal annual installments, commencing on the first anniversary of the grant date. The weighted average fair value of the service options granted through the first nine months of 2013 was $4.86 per share. The fair value of service options granted during 2013 was estimated on the date of grant using the Black-Scholes option pricing model with an expected life of 4 years, an expected volatility of 35%, a weighted average annual rate of quarterly dividends of 3.3% and a weighted average risk free interest rate of 0.73%.

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 Auction Services, Inc. service and exit options as equity awards. We have classified the KAR LLC and Axle LLC profit interests as liability awards. The main difference between a liability-classified award and an equity-classified award is that liability-classified awards are 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 September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Service options	$0.8	$0.7	$2.2	$1.9
Exit options	0.3	1.9	2.3	7.0
KAR LLC profit interests	3.3	2.7	3.8	6.4
Axle LLC profit interests	8.0	2.3	8.5	5.6
Total	$12.4	$7.6	$16.8	$20.9

For the three and nine months ended September 30, 2013, approximately $0.7 million of the KAR LLC profit interest expense and approximately $6.1 million of the Axle LLC profit interest expense related to value units. There is no income tax benefit recognized by us with respect to the KAR LLC and Axle LLC profit interests. The total income tax benefit recognized in the consolidated statement of income for options was approximately $0.4 million and $0.9 million for the three months ended September 30, 2013 and 2012, respectively, and $1.6 million and $3.1 million for the nine months ended September 30, 2013 and 2012, respectively.

On March 1, 2013, the board of directors approved amendments to the outstanding exit options that previously vested based on a 90-day average closing price of the Company's common stock being above a stated dollar amount. Generally, such vesting terms were amended to require that the average closing price over a period of 90 trading days be greater than a specified dollar amount to instead requiring that the closing price be greater than the specified dollar amount over a period of 20 consecutive trading days. As a result of this change, effective on March 1, 2013, approximately 1.4 million of such exit options became vested. The incremental expense related to the modification was immaterial.

In May 2013, the vesting criteria for the third 25% of the exit options originally granted under the Axle Holdings, Inc. Stock Incentive Plan was met and as such, an additional 25% of the outstanding exit options became exercisable. In August 2013, the vesting criteria for the final 25% of the exit options originally granted under the Axle Holdings, Inc. Stock Incentive Plan was met and as such, the final 25% of the outstanding exit options became exercisable.

In August 2013, the vesting criteria for the second 25% of the exit options granted under the KAR Auction Services, Inc. Stock Incentive Plan and the Omnibus Plan was met and as such, an additional 25% of the outstanding exit options became exercisable.

10

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Note 4—Net Income Per Share
The following table sets forth the computation of net income per share (in millions except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	$22.8	$19.2	$85.3	$69.1
Weighted average common shares outstanding	138.3	136.5	137.5	136.4
Effect of dilutive stock options	3.0	2.7	2.9	2.4
Weighted average common shares outstanding and potential common shares	141.3	139.2	140.4	138.8
Net income per share				
Basic	$0.16	$0.14	$0.62	$0.51
Diluted	$0.16	$0.14	$0.61	$0.50

Basic net income per share was calculated by dividing net income by the weighted-average number of outstanding common shares for the period. Diluted net income per share was calculated consistent with basic net income 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 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 diluted share are excluded from the calculations. Approximately 0.4 million options were excluded from the calculation of diluted net income per share for the three months ended September 30, 2012, and approximately 0.2 million and 0.8 million options were excluded from the calculation of diluted net income per share for the nine months ended September 30, 2013 and 2012, respectively. Total options outstanding at September 30, 2013 and 2012 were 7.8 million and 9.7 million, respectively.

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 group of bank purchasers of undivided interests in certain eligible finance receivables subject to committed liquidity. AFC Funding Corporation had committed liquidity of $800 million for U.S. finance receivables at September 30, 2013.

In June 2013, AFC and AFC Funding Corporation entered into the Fifth Amended and Restated Receivables Purchase Agreement (the “Receivables Purchase Agreement”). The Receivables Purchase Agreement increased AFC Funding's U.S. committed liquidity from $650 million to $800 million and extended the facility's maturity date from June 30, 2014 to June 30, 2016. In addition, certain of the covenants and termination events in the Receivables Purchase Agreement that are tied to the performance of the finance receivables portfolio were modified. In the second quarter of 2013, we recorded a $0.7 million pretax charge primarily resulting from the write-off of unamortized securitization issuance costs associated with the amendment.

We also have an agreement for the securitization of Automotive Finance Canada, Inc.'s ("AFCI") receivables. In June 2013, AFCI entered into the Second Amended and Restated Receivables Purchase Agreement (the “Canadian Receivables Purchase Agreement”). The Canadian Receivables Purchase Agreement extended the facility's maturity date from June 30, 2014 to June 30, 2016. In addition, certain of the covenants and termination events in the Canadian Receivables Purchase Agreement that are tied to the performance of the finance receivables portfolio were modified. AFCI's committed liquidity is provided through a third party conduit (separate from the U.S. facility) and was C$100 million at September 30, 2013. The receivables sold pursuant to both the U.S. and Canadian securitization agreements are accounted for as secured borrowings.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

The following table presents 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.

	September 30, 2013			
	Principal Amount of:			
(in millions)	Receivables	Receivables Delinquent	Net Credit Losses Three Months Ended September 30, 2013	Net Credit Losses Nine Months Ended September 30, 2013
Floorplan receivables	$1,065.6	$4.5	$1.7	$6.3
Other loans	8.4	—	—	—
Total receivables managed	$1,074.0	$4.5	$1.7	$6.3

	December 31, 2012			
	Principal Amount of:			
(in millions)	Receivables	Receivables Delinquent	Net Credit Losses Three Months Ended September 30, 2012	Net Credit Losses Nine Months Ended September 30, 2012
Floorplan receivables	$996.2	$3.8	$0.9	$5.4
Other loans	8.0	—	0.2	0.2
Total receivables managed	$1,004.2	$3.8	$1.1	$5.6

AFC's allowance for losses was $8.0 million at September 30, 2013 and December 31, 2012.

As of September 30, 2013 and December 31, 2012, $1,065.1 million and $996.0 million, respectively, of finance receivables and a cash reserve of 1 percent of the obligations collateralized by finance receivables served as security for the $742.4 million and $713.3 million of obligations collateralized by finance receivables at September 30, 2013 and December 31, 2012, respectively.

Proceeds from the revolving sale of receivables to the bank facilities 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 September 30, 2013, we were in compliance with the covenants in the securitization agreements.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Note 6—Long-Term Debt
Long-term debt consisted of the following (in millions):

	Interest Rate			Maturity	September 30, 2013	December 31, 2012
Term Loan B	Adjusted LIBOR	+ 2.75	%	May 18, 2017	$1,775.3	$1,674.5
$250 million revolving credit facility	Adjusted LIBOR	+ 3.50	%	May 18, 2016	—	—
Floating rate senior notes	LIBOR	+ 4.00	%		—	150.0
Canadian line of credit	CAD Prime	+ 1.50	%	Repayable upon demand	—	—
Total debt					1,775.3	1,824.5
Unamortized debt discount					(5.0)	(6.2)
Current portion of long-term debt					—	(43.7)
Long-term debt					$1,770.3	$1,774.6

Credit Facilities
In March 2013, we entered into the Second Amendment to the Credit Agreement. The amendment increased Term Loan B $150.0 million to $1.8 billion and decreased the interest rate on Term Loan B to Adjusted LIBOR plus 2.75% from Adjusted LIBOR plus 3.75%. In addition, the adjusted LIBOR rate floor decreased to 1.0% from 1.25%. The interest rate on Term Loan B was 3.75% at September 30, 2013. For the nine months ended September 30, 2013, we recorded a $3.9 million pretax charge resulting from certain expenses related to the Credit Agreement amendment, as well as the write-off of certain unamortized debt issuance costs associated with the term loan. The additional $150.0 million in proceeds received from Term Loan B were used to redeem the floating rate senior notes due 2014 on April 3, 2013. In the second quarter of 2013, we recorded a $0.8 million pretax charge primarily resulting from the write-off of unamortized debt issuance costs associated with the floating rate senior notes.
Term Loan B is payable in quarterly installments equal to 0.25% of the aggregate principal amount as of the Second Amendment effective date, and commenced on March 31, 2013. The Credit Facility is subject to mandatory prepayments and reduction in an amount equal to (i) the net proceeds of certain debt offerings, asset sales and certain insurance recovery events; and (ii) for any fiscal year ending on or after December 31, 2011, any Excess Cash Flow, as defined in the Credit Agreement, on or before the 105th day following the end of the fiscal year. In April 2013, the Company made an excess cash flow payment of $39.4 million for the year ended December 31, 2012. In addition, in accordance with the terms of the Credit Agreement, 50% of the net cash proceeds from the sale-leaseback of certain technology and capital equipment were used to prepay $5.2 million of Term Loan B in the first nine months of 2013. The prepayments were credited to prepay in order of maturity the unpaid amounts due on the next eight scheduled quarterly installments of Term Loan B, and thereafter to the remaining scheduled quarterly installments of Term Loan B on a pro rata basis. As such, after the debt prepayments, there are no further quarterly installments due until June 30, 2015.
There were no borrowings on the revolving credit facility at September 30, 2013 or December 31, 2012. However, we had related outstanding letters of credit in the aggregate amount of $23.6 million at September 30, 2013 and December 31, 2012, respectively, which reduce the amount available for borrowings under the credit facility. As of September 30, 2013, we were in compliance with the covenants in the Credit Agreement.
Fair Value of Debt
As of September 30, 2013, the estimated fair value of our long-term debt amounted to $1,777.5 million. The estimates of fair value are based on broker-dealer quotes for our debt as of September 30, 2013. The estimates presented on long-term financial instruments are not necessarily indicative of the amounts that would be realized in a current

market exchange.

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

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. We use interest rate derivatives with the objective of managing exposure to interest rate movements, thereby reducing the effect of interest rate changes and the effect they could have on future cash flows. Currently, interest rate cap agreements are used to accomplish this objective. In August 2013, we purchased four interest rate caps for an aggregate amount of approximately $2.2 million with an aggregate notional amount of $1.2 billion to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility when three-month LIBOR exceeds 1.0%. The interest rate cap agreements each had an effective date of August 16, 2013 and each mature on August 16, 2015. The unamortized portion of the $2.2 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.

Accounting Standards Codification ("ASC") 815, Derivatives and Hedging, requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. 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			
	September 30, 2013		December 31, 2012	
Derivatives Not Designated as Hedging Instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Interest rate caps	Other assets	$1.4	Other assets	N/A

We have not designated any of the interest rate caps as hedges for accounting purposes. Accordingly, changes in the fair value of the interest rate caps are recognized as "Interest expense" in the consolidated statement of income. The following table presents the effect of the interest rate derivatives on our consolidated statements of income for the periods presented (in millions):

		Amount of Gain / (Loss) Recognized in Income on Derivative			
	Location of Gain / (Loss) Recognized in Income on Derivative	Three Months Ended September 30,		Nine Months Ended September 30,	
Derivatives Not Designated as Hedging Instruments		2013	2012	2013	2012
Interest rate caps	Interest expense	$(0.8)	N/A	$(0.8)	N/A

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 incurrence 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 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, 2012.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Note 9—Accumulated Other Comprehensive Income

Accumulated other comprehensive income consisted of the following (in millions):

	September 30, 2013	December 31, 2012
Foreign currency translation gain	$25.4	$35.1
Unrealized loss on interest rate derivatives, net of tax	—	(0.2)
Unrealized gain on postretirement benefit obligation, net of tax	0.2	0.2
Accumulated other comprehensive income	$25.6	$35.1

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.

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

Description	September 30, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Interest rate caps	$1.4	$—	$1.4	$—

Interest Rate Caps - Under the interest rate cap agreements purchased in August 2013, we receive interest on a notional amount when three-month LIBOR exceeds 1.0%. The fair value of the interest rate caps is based on quoted market prices for similar instruments from commercial banks.

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Note 11—Related Party Transactions

At September 30, 2013, affiliates of the Equity Sponsors, other equity co-investors and members of our management held approximately 20.3% of our outstanding common stock directly or indirectly through their investment in KAR LLC. Pursuant to a registration rights agreement entered into with the Equity Sponsors, KAR LLC caused us to file a registration statement (Registration No. 333-174038) under the Securities Act. In March 2013, June 2013, August 2013 and September 2013, pursuant to the registration statement, KAR LLC sold 14,950,000; 17,250,000; 17,250,000; and 13,800,000, respectively, of its shares in KAR Auction Services. We incurred expenses of approximately $1.2 million related to such sales and we received no proceeds from the sales. The expenses related to the sales were recorded to "Selling, general and administrative" in the consolidated statement of income.

Note 12—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 administrative costs allocated by the holding company.

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Financial information regarding our reportable segments is set forth below for the three months ended September 30, 2013 (in millions):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	$275.4	$198.8	$59.5	$—	$533.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	152.0	128.1	16.1	—	296.2
Selling, general and administrative	62.8	20.4	6.4	30.7	120.3
Depreciation and amortization	22.6	18.5	7.2	1.3	49.6
Total operating expenses	237.4	167.0	29.7	32.0	466.1
Operating profit (loss)	38.0	31.8	29.8	(32.0)	67.6
Interest expense	0.2	0.2	4.6	21.0	26.0
Other (income) expense, net	(0.6)	(0.2)	—	—	(0.8)
Intercompany expense (income)	14.8	9.6	(5.6)	(18.8)	—
Income (loss) before income taxes	23.6	22.2	30.8	(34.2)	42.4
Income taxes	9.1	8.4	12.0	(9.9)	19.6
Net income (loss)	$14.5	$13.8	$18.8	$(24.3)	$22.8
Assets	$2,328.7	$1,180.0	$1,531.4	$81.9	$5,122.0

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

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	$257.0	$167.4	$50.5	$—	$474.9
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	147.2	106.0	10.9	—	264.1
Selling, general and administrative	61.6	14.8	5.0	20.9	102.3
Depreciation and amortization	23.5	17.1	5.7	0.5	46.8
Total operating expenses	232.3	137.9	21.6	21.4	413.2
Operating profit (loss)	24.7	29.5	28.9	(21.4)	61.7
Interest expense	0.2	0.3	3.8	25.6	29.9
Other (income) expense, net	(0.7)	(0.2)	—	(0.3)	(1.2)
Intercompany expense (income)	15.0	9.5	(4.6)	(19.9)	—
Income (loss) before income taxes	10.2	19.9	29.7	(26.8)	33.0
Income taxes	4.6	7.7	10.9	(9.4)	13.8
Net income (loss)	$5.6	$12.2	$18.8	$(17.4)	$19.2
Assets	$2,402.1	$1,164.5	$1,323.8	$35.6	$4,926.0

Table of Contents

KAR Auction Services, Inc.
Notes to Consolidated Financial Statements (Continued)
September 30, 2013 (Unaudited)

Financial information regarding our reportable segments is set forth below for the nine months ended September 30, 2013 (in millions):

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	$844.3	$623.2	$165.2	$—	$1,632.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	469.8	416.4	40.3	—	926.5
Selling, general and administrative	187.7	59.5	18.2	67.9	333.3
Depreciation and amortization	66.8	55.4	20.3	3.4	145.9
Total operating expenses	724.3	531.3	78.8	71.3	1,405.7
Operating profit (loss)	120.0	91.9	86.4	(71.3)	227.0
Interest expense	0.7	0.7	12.3	65.6	79.3
Other (income) expense, net	(2.0)	(0.5)	—	—	(2.5)
Loss on modification/extinguishment of debt	—	—	0.7	4.7	5.4
Intercompany expense (income)	45.6	28.8	(15.2)	(59.2)	—
Income (loss) before income taxes	75.7	62.9	88.6	(82.4)	144.8
Income taxes	28.2	23.6	34.2	(26.5)	59.5
Net income (loss)	$47.5	$39.3	$54.4	$(55.9)	$85.3

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

	ADESA Auctions	IAA	AFC	Holding Company	Consolidated
Operating revenues	$791.4	$534.1	$144.2	$—	$1,469.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	442.6	322.8	31.3	—	796.7
Selling, general and administrative	189.6	52.7	16.1	61.5	319.9
Depreciation and amortization	73.6	50.8	17.6	1.4	143.4
Total operating expenses	705.8	426.3	65.0	62.9	1,260.0
Operating profit (loss)	85.6	107.8	79.2	(62.9)	209.7
Interest expense	0.8	1.1	11.2	76.7	89.8
Other (income) expense, net	(1.8)	0.5	—	(0.3)	(1.6)
Intercompany expense (income)	45.2	28.7	(13.1)	(60.8)	—
Income (loss) before income taxes	41.4	77.5	81.1	(78.5)	121.5
Income taxes	19.5	30.8	29.8	(27.7)	52.4
Net income (loss)	$21.9	$46.7	$51.3	$(50.8)	$69.1

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; dividend declarations and payments; strategic initiatives, greenfields and acquisitions; our competitive position and retention of customers; 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, 2012 filed on February 22, 2013. 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;
- trends in the number of commercial vehicles being brought to auction, in-particular off-lease volumes;
- changes in the volume of vehicle production, including capacity reductions at the major original equipment manufacturers;
- increases in the number of used 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;
- 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 maintain our brand and protect our intellectual property;
- 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;
- weather, including increased expenses as a result of catastrophic events;

- 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. 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.

- The ADESA Auctions segment serves a domestic and international customer base through live and online auctions and through 66 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. Through its OPENLANE technology, ADESA offers comprehensive private label remarketing solutions to automobile manufacturers, captive finance companies and other institutions to offer vehicles via the internet prior to arrival at the physical auction. 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, titling and other administrative services.
- The IAA segment serves a domestic and international customer base through live and online auctions and through 163 salvage vehicle auction sites in the United States and Canada at September 30, 2013. The salvage auctions facilitate the remarketing of damaged vehicles designated as total losses by insurance companies, charity donation vehicles, recovered stolen (or theft) vehicles and low value used vehicles. The salvage auction business specializes in providing services such as inbound 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 September 30, 2013, AFC conducted business at 105 locations in the United States and Canada.

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 administrative costs allocated by the holding company.

Industry Trends

Whole Car

Used vehicles sold in North America through whole car auctions were 8.4 million, 7.7 million and 7.9 million in 2010, 2011 and 2012, respectively (excluding approximately 0.3 million used vehicles sold by OPENLANE in 2011 and 2012). The reduction in auction volumes since 2009, when industry volumes exceeded 9 million used vehicles sold, is attributable to supply shortages in the North American whole car auction industry caused principally by declines in new vehicle sales and lease originations from 2007 to 2009 and declines in repossessions from 2009 to 2012. The supply shortages and resulting decline in industry auction volumes reflected a reduction in units sold by institutional consignors. This reduction was partially offset by an increase in dealer consignment units sold in 2010 and 2011. In 2012, overall auction volumes increased over 2011, as an increase in dealer consignment units more than offset the decline in institutional volume.

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 three years to approximately 14.5 million units in 2012, the recovery in new vehicles sales has been gradual and may continue to be so for the foreseeable future.
- The previous decline 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 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, new vehicle 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. Despite changes in the number of trade-ins dealers keep for retail sale as compared to periods prior to 2010, the number of dealer consignment vehicles remarketed through whole car auctions has increased since 2010.
- 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. This decline negatively impacted the supply of off-lease vehicles available at auction through 2012.

We estimate that used vehicle auction volumes in North America, including units sold by OPENLANE, will exceed 8.5 million units in 2013 and are expected to be over 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 was approximately 14% for 2012, up from approximately 13% in 2011. 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.

Fluctuations in used vehicle and commodity pricing have an impact on proceeds received in the salvage vehicle auction industry. In times of rising prices, as the industry has experienced over the last few years, revenue and gross profit are positively impacted. If used vehicle and commodity prices continue to moderate in 2013, proceeds, revenue and gross profit at salvage auctions may be negatively impacted, which could adversely affect the level of profitability.

Automotive Finance

AFC works with independent used vehicle dealers to improve their results by providing a comprehensive set of business and financial solutions that leverages its local branches, industry experience and scale, as well as KAR affiliations. Over the last few years, the U.S. independent used vehicle dealer base has rebounded from approximately 36,000 dealers in 2009 to about 38,000 dealers in 2012. During this time, AFC's dealer base has grown from 9,745 dealers in 2009 to approximately 11,000 dealers in 2012 and loan transactions, which includes both loans paid off and loans curtailed, have grown from 799,421 in 2009 to 1,239,755 in 2012.

Key challenges for the independent used vehicle dealer include used vehicle sales volume demand, disruptions in pricing of used vehicle inventory and lack of access to consumer financing. These same challenges, to the extent they occur, could result in a material negative impact on AFC's results of operations. A significant decline in used vehicle sales would result in a decrease in consumer auto loan originations and an increased number of dealers defaulting on their loans. In addition, volatility in wholesale vehicle pricing impacts the value of recovered collateral on defaulted loans and the resulting severity of credit losses at AFC.

AFC implemented a number of strategic initiatives in recent years to enhance credit standards, improve portfolio risk management and enhance the customer experience. In addition, in June 2013, AFC acquired a service contract business as part of its strategy to provide new services to independent used vehicle dealers. These initiatives, along with the current industry environment, have enabled AFC to increase its penetration of the independent dealer base while maintaining a high level of portfolio quality evidenced by low levels of net credit losses and a managed portfolio which was over 99 percent current at September 30, 2013.

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, interest income and other service revenue 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, service contract claims, maintenance and lease expense related to the auction sites and loan offices. Cost of services excludes depreciation and amortization. Selling, general 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, Inc. for the Three Months Ended September 30, 2013 and 2012:

	Three Months Ended September 30,	
(Dollars in millions except per share amounts)	2013	2012
Revenues		
ADESA	$275.4	$257.0
IAA	198.8	167.4
AFC	59.5	50.5
Total revenues	533.7	474.9
Cost of services*	296.2	264.1
Gross profit*	237.5	210.8
Selling, general and administrative	120.3	102.3
Depreciation and amortization	49.6	46.8
Operating profit	67.6	61.7
Interest expense	26.0	29.9
Other income, net	(0.8)	(1.2)
Income before income taxes	42.4	33.0
Income taxes	19.6	13.8
Net income	$22.8	$19.2
Net income per share		
Basic	$0.16	$0.14
Diluted	$0.16	$0.14

* Exclusive of depreciation and amortization

For the three months ended September 30, 2013, we had revenue of $533.7 million compared with revenue of $474.9 million for the three months ended September 30, 2012, an increase of 12%. 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 $2.8 million, or 6%, to $49.6 million for the three months ended September 30, 2013, compared with $46.8 million for the three months ended September 30, 2012. The increase in depreciation and amortization resulted from assets placed in service during 2013.

Interest Expense

Interest expense decreased $3.9 million, or 13%, to $26.0 million for the three months ended September 30, 2013, compared with $29.9 million for the three months ended September 30, 2012. The decrease in interest expense was primarily due to the decrease in the interest rate on Term Loan B debt which was refinanced on March 12, 2013. The interest rate on Term Loan B debt was 3.75% at September 30, 2013 compared with an interest rate of 5% at September 30, 2012.

Other Income, Net

We had other income of $0.8 million for the three months ended September 30, 2013, compared with $1.2 million for the three months ended September 30, 2012. The change in other income was primarily representative of a decrease in foreign currency transaction gains.

Income Taxes

We had an effective tax rate of 46.2% for the three months ended September 30, 2013, compared with an effective tax rate of 41.8% for the three months ended September 30, 2012. Excluding the effect of the discrete items, our effective tax rate for the three months ended September 30, 2013 and 2012 would have been 41.6%. Income before income taxes includes the impact, if any, of profit interest expense which is not deductible by us for income tax purposes. For the three months ended

September 30, 2013 and 2012 there was profit interest expense of $11.3 million and $5.0 million, respectively. Excluding the effect of the nondeductible profit interest expense on income before income taxes, the Company's income taxes for the three months ended September 30, 2013 and 2012 would have been 36.5% and 36.3% of income before income taxes, respectively.

ADESA Results

	Three Months Ended September 30,	
(Dollars in millions)	2013	2012
ADESA revenue	$275.4	$257.0
Cost of services*	152.0	147.2
Gross profit*	123.4	109.8
Selling, general and administrative	62.8	61.6
Depreciation and amortization	22.6	23.5
Operating profit	$38.0	$24.7

* Exclusive of depreciation and amortization

Revenue

Revenue from ADESA increased $18.4 million, or 7%, to $275.4 million for the three months ended September 30, 2013, compared with $257.0 million for the three months ended September 30, 2012. The increase in revenue was primarily a result of a 13% increase in the number of vehicles sold, partially offset by a 5% decrease in revenue per vehicle sold to approximately $535 for the three months ended September 30, 2013, compared with approximately $565 for the three months ended September 30, 2012.

The total number of used vehicles sold at ADESA increased 13% for the three months ended September 30, 2013, compared with the three months ended September 30, 2012. The increase in volume sold was attributable to a 16% increase in institutional volume, including vehicles sold on our online only platform, as well as a 10% increase in dealer consignment units sold in the third quarter of 2013 compared with the third quarter of 2012. Online sales volumes for ADESA represented approximately 35% of the total vehicles sold in the third quarter of 2013, compared with approximately 28% in the third quarter of 2012. "Online sales" includes the following: (i) selling vehicles directly from a dealership or other interim storage location (upstream selling); (ii) online solutions that offer vehicles for sale while in transit to auction locations (midstream selling); (iii) simultaneously broadcasting video and audio of the physical auctions to online bidders (LiveBlock®); and (iv) bulletin-board or real-time online auctions (DealerBlock®). Both the upstream and midstream selling represent "online only" sales, which represent approximately half of ADESA's online sales volume.

Revenue per vehicle sold decreased 5% as a result of a decrease in the utilization of ancillary services as a result of more vehicles being sold online as well as the change in mix of vehicles towards more dealer consignment cars sold at physical auction locations. Vehicles sold online and dealer consignment cars utilize fewer ancillary services than institutional vehicles sold at physical auction locations. The used vehicle conversion percentage at physical auction locations, calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale at our ADESA auctions, increased to 56.6% for the three months ended September 30, 2013, compared with 55.3% for the three months ended September 30, 2012. For the three months ended September 30, 2013, dealer consignment vehicles represented approximately 52% of used vehicles sold at ADESA physical auction locations, an increase from approximately 51% for the three months ended September 30, 2012.

Gross Profit

For the three months ended September 30, 2013, gross profit for ADESA increased $13.6 million, or 12%, to $123.4 million, compared with $109.8 million for the three months ended September 30, 2012. Gross profit for ADESA was 44.8% of revenue for the three months ended September 30, 2013, compared with 42.7% of revenue for the three months ended September 30, 2012. The increase in gross profit as a percentage of revenue for the three months ended September 30, 2013, compared with the three months ended September 30, 2012, was primarily the result of the 7% increase in revenue. In addition, cost of services also benefited from the lower utilization of ancillary services as a result of increases in both vehicles sold online and dealer consignment cars.

Selling, General and Administrative

Selling, general and administrative expenses for the ADESA segment increased $1.2 million, or 2%, to $62.8 million for the three months ended September 30, 2013, compared with $61.6 million for the three months ended September 30, 2012, primarily due to increases in incentive-based compensation and compensation expense, partially offset by a reduction in loss on the sale of idle property.

IAA Results

	Three Months Ended September 30,	
(Dollars in millions)	2013	2012
IAA revenue	$198.8	$167.4
Cost of services*	128.1	106.0
Gross profit*	70.7	61.4
Selling, general and administrative	20.4	14.8
Depreciation and amortization	18.5	17.1
Operating profit	$31.8	$29.5

* Exclusive of depreciation and amortization

Revenue

Revenue from IAA increased $31.4 million, or 19%, to $198.8 million for the three months ended September 30, 2013, compared with $167.4 million for the three months ended September 30, 2012. The increase in revenue was a result of an increase in vehicles sold of approximately 16% for the three months ended September 30, 2013, as well as increases in revenue per vehicle sold. IAA's total loss vehicle inventory has increased over 15% at September 30, 2013, as compared to September 30, 2012. Vehicles sold under purchase agreements were approximately 8% of total salvage vehicles sold for the three months ended September 30, 2013 and 2012. Online sales volumes for IAA for the three months ended September 30, 2013 and 2012 represented approximately half of the total vehicles sold by IAA.

Gross Profit

For the three months ended September 30, 2013, gross profit at IAA increased to $70.7 million, or 35.6% of revenue, compared with $61.4 million, or 36.7% of revenue, for the three months ended September 30, 2012. The gross profit increase was primarily the result of the increase in volume. The decrease in gross profit as a percentage of revenue was mainly attributable to an increase in expenses associated with volume increases, including transportation and labor related costs. An increase in the purchase price of vehicles sold under purchase agreements also contributed to the decrease in gross profit percentage, as the entire selling price of the vehicle is recorded as revenue and cost of services.

Selling, General and Administrative

Selling, general and administrative expenses at IAA increased $5.6 million, or 38%, to $20.4 million for the three months ended September 30, 2013, compared with $14.8 million for the three months ended September 30, 2012. The increase in selling, general and administrative expenses was attributable to increases in incentive-based compensation expense and information technology costs.

AFC Results

	Three Months Ended September 30,	
(Dollars in millions except volumes and per loan amounts)	2013	2012
AFC revenue		
Interest and fee income	$53.4	$47.9
Other revenue	2.7	2.7
Provision for credit losses	(1.7)	(0.1)
Other service revenue	5.1	—
Total AFC revenue	59.5	50.5
Cost of services*	16.1	10.9
Gross profit*	43.4	39.6
Selling, general and administrative	6.4	5.0
Depreciation and amortization	7.2	5.7
Operating profit	$29.8	$28.9
Loan transactions	342,281	313,079
Revenue per loan transaction, excluding "Other service revenue"	$159	$161

* Exclusive of depreciation and amortization

Revenue

For the three months ended September 30, 2013, AFC revenue increased $9.0 million, or 18%, to $59.5 million, compared with $50.5 million for the three months ended September 30, 2012. The increase in revenue was the result of a 9% increase in loan transactions and $5.1 million of "Other service revenue" generated by Preferred Warranties, Inc. ("PWI"), for the three months ended September 30, 2013, compared with the same period in 2012, partially offset by a 1% decrease in revenue per loan transaction for the three months ended September 30, 2013. PWI, a service contract business, was acquired in June 2013. In addition, managed receivables increased to $1,074.0 million at September 30, 2013 from $938.5 million at September 30, 2012.

Revenue per loan transaction, which includes both loans paid off and loans curtailed, decreased $2, or 1%, primarily as a result of an increase in the provision for credit losses, partially offset by increases in floorplan fee income, average loan values and average loan duration. Revenue per loan transaction excludes "Other service revenue."

Gross Profit

For the three months ended September 30, 2013, gross profit for the AFC segment increased $3.8 million, or 10%, to $43.4 million, compared with $39.6 million for the three months ended September 30, 2012, primarily as a result of an 18% increase in revenue, partially offset by a 48% increase in cost of services. The increase in cost of services was primarily the result of the inclusion of expenses associated with PWI, as well as increases in compensation expense.

Selling, General and Administrative

Selling, general and administrative expenses at AFC increased $1.4 million, or 28%, to $6.4 million, for the three months ended September 30, 2012, compared with $5.0 million for the three months ended September 30, 2012. The increase was primarily the result of expenses associated with PWI, as well as increases in compensation expense.

Holding Company Results

	Three Months Ended September 30,	
(Dollars in millions)	2013	2012
Selling, general and administrative	$30.7	$20.9
Depreciation and amortization	1.3	0.5
Operating loss	$(32.0)	$(21.4)

Selling, General and Administrative

For the three months ended September 30, 2013, selling, general and administrative expenses at the holding company increased $9.8 million, or 47%, to $30.7 million, compared with $20.9 million for the three months ended September 30, 2012, primarily as a result of an increase in stock-based compensation expense related to the KAR LLC and Axle LLC profit interests, as well as an increase in incentive-based compensation, compensation expense and other employee related expenses. For the three months ended September 30, 2013, stock-based compensation expense related to the KAR LLC and Axle LLC operating and value units was $11.3 million, compared with $5.0 million for the three months ended September 30, 2012. For the three months ended September 30, 2013, approximately $8.2 million was paid to the KAR LLC profit interest holders and approximately $14.2 million was paid to the Axle LLC profit interest holders. The cash received by the profit interest holders was paid by KAR LLC and Axle LLC. None of the Company's cash was used to pay the profit interest holders.

Overview of Results of KAR Auction Services, Inc. for the Nine Months Ended September 30, 2013 and 2012:

	Nine Months Ended September 30,	
(Dollars in millions except per share amounts)	2013	2012
Revenues		
ADESA	$844.3	$791.4
IAA	623.2	534.1
AFC	165.2	144.2
Total revenues	1,632.7	1,469.7
Cost of services*	926.5	796.7
Gross profit*	706.2	673.0
Selling, general and administrative	333.3	319.9
Depreciation and amortization	145.9	143.4
Operating profit	227.0	209.7
Interest expense	79.3	89.8
Other income, net	(2.5)	(1.6)
Loss on modification/extinguishment of debt	5.4	—
Income before income taxes	144.8	121.5
Income taxes	59.5	52.4
Net income	$85.3	$69.1
Net income per share		
Basic	$0.62	$0.51
Diluted	$0.61	$0.50

* Exclusive of depreciation and amortization

For the nine months ended September 30, 2013, we had revenue of $1,632.7 million compared with revenue of $1,469.7 million for the nine months ended September 30, 2012, an increase of 11%. For a further discussion of revenues, gross profit and selling, general and administrative expenses, see the segment results discussions below.

Superstorm Sandy

In October 2012, Superstorm Sandy damaged property throughout the Eastern United States with the most significant damage concentrated in New Jersey and New York. As a direct result of Superstorm Sandy's effect on New York City and neighboring communities, damage from the storm is estimated at over $70 billion. Although the damage from Superstorm Sandy was widespread, the most significant damage was concentrated on the eastern seaboard of the United States. KAR and its subsidiaries did not experience significant damage to its properties or vehicles stored on our properties for our customers. Certain auction activities were delayed due to power outages, temporary loss of internet access and the inability of customers to attend the auctions immediately following the damage created by Superstorm Sandy.

IAA provides salvage auction services to substantially all of the major automobile insurance companies in the United States. Contracts with IAA's insurance customers require IAA to provide services in the event of catastrophic events like Superstorm Sandy. Typically these catastrophic events create a temporary increase in the number of cars processed and sold. The nature of the damage, the need to service our customers in a short period of time and the geographic concentration in a heavily populated, high cost area, led to substantially increased costs incurred to handle the significantly greater volumes of vehicles.

Superstorm Sandy was unique in that its impact was greatest in the densely populated New York City area. This resulted in a high concentration of total-loss vehicles in a relatively small geographic area. It is estimated that Superstorm Sandy damaged over 200,000 vehicles. IAA's customers assigned over 50,000 total-loss vehicles to IAA for processing. In order to store and process these vehicles, IAA secured over 400 acres of temporary space in New York and New Jersey. In addition, the difficult infrastructure of the New York City and Long Island areas and the shortage of towing capacity required IAA to incur significantly greater towing costs to move damaged vehicles to its sites for processing. In order to serve our customers in this region, IAA had to bring hundreds of employees to the affected areas to assist in the timely processing of these vehicles. All of these activities resulted in a temporary increase in costs related to Superstorm Sandy vehicles.

In the first nine months of 2013, IAA sold over 45,000 Superstorm Sandy vehicles resulting in revenue of approximately $29.7 million and cost of services of approximately $43.2 million. Overall, IAA incurred a pre-tax net loss of $13.5 million related to the processing of Superstorm Sandy vehicles in the first nine months of 2013. This net loss has been excluded from Adjusted EBITDA in accordance with the definitions in our Credit Agreement. These losses are net of auction services revenue realized upon the sale of the vehicles. The significantly higher tow costs incurred in order to respond to the requirements of our customers, increased occupancy costs due to the leasing of temporary locations to process Superstorm Sandy vehicles and increased labor costs for the temporary work force brought into the New York and New Jersey area has resulted in a net loss on the sale of the Superstorm Sandy vehicles.

Depreciation and Amortization

Depreciation and amortization increased $2.5 million, or 2%, to $145.9 million for the nine months ended September 30, 2013, compared with $143.4 million for the nine months ended September 30, 2012. The increase in depreciation and amortization was due to an increase in depreciation resulting from certain assets placed in service over the last twelve months.

Interest Expense

Interest expense decreased $10.5 million, or 12%, to $79.3 million for the nine months ended September 30, 2013, compared with $89.8 million for the nine months ended September 30, 2012. The decrease in interest expense was primarily due to the decrease in the interest rate on Term Loan B debt which was refinanced on March 12, 2013. The interest rate on Term Loan B debt was 3.75% at September 30, 2013 compared with an interest rate of 5% at September 30, 2012.

Other Income, Net

We had other income of $2.5 million for the nine months ended September 30, 2013, compared with $1.6 million for the nine months ended September 30, 2012. The change in other income was primarily due to $1.0 million of contingent consideration that was recorded in the first nine months of 2012.

Loss on Modification/Extinguishment of Debt

In March 2013, we amended our Credit Agreement and have recorded a $3.9 million pretax charge resulting from certain expenses related to the Credit Agreement amendment, as well as the write-off of certain unamortized debt issuance costs associated with the term loan. Additionally, in April 2013, we prepaid the $150.0 million principal amount of the floating rate senior notes with proceeds received from refinancing Term Loan B as part of the Second Amendment to the Credit Agreement. In the second quarter of 2013, we recorded a $0.8 million pretax charge primarily resulting from the write-off of unamortized debt issuance costs associated with the floating rate senior notes. Finally, in the second quarter of 2013, we recorded a $0.7

million pretax charge primarily resulting from the write-off of unamortized securitization issuance costs associated with AFC's Receivables Purchase Agreement.

Income Taxes

We had an effective tax rate of 41.1% for the nine months ended September 30, 2013, compared with an effective tax rate of 43.1% for the nine months ended September 30, 2012. Excluding the effect of the discrete items, our effective tax rate for the nine months ended September 30, 2013 and 2012 would have been 41.6%. Income before income taxes includes the impact, if any, of profit interest expense which is not deductible by us for income tax purposes. For the nine months ended September 30, 2013 and 2012 there was profit interest expense of $12.3 million and $12.0 million, respectively. Excluding the effect of the nondeductible profit interest expense on income before income taxes, the Company's income taxes for the nine months ended September 30, 2013 and 2012 would have been 37.9% and 39.3% of income before income taxes, respectively.

ADESA Results

	Nine Months Ended September 30,	
(Dollars in millions)	2013	2012
ADESA revenue	$844.3	$791.4
Cost of services*	469.8	442.6
Gross profit*	374.5	348.8
Selling, general and administrative	187.7	189.6
Depreciation and amortization	66.8	73.6
Operating profit	$120.0	$85.6

* Exclusive of depreciation and amortization

Revenue

Revenue from ADESA increased $52.9 million, or 7%, to $844.3 million for the nine months ended September 30, 2013, compared with $791.4 million for the nine months ended September 30, 2012. The increase in revenue was primarily a result of a 9% increase in the number of vehicles sold, partially offset by a 2% decrease in revenue per vehicle sold to over $540 for the nine months ended September 30, 2013, compared with over $550 for the nine months ended September 30, 2012.

The total number of used vehicles sold at ADESA increased 9% for the nine months ended September 30, 2013, compared with the nine months ended September 30, 2012. The increase in volume sold was attributable to an increase in institutional volume, including vehicles sold on our online only platform, as well as a 7% increase in dealer consignment units sold in the first nine months of 2013 compared with the first nine months of 2012. Online sales volumes for ADESA represented approximately 35% of the total vehicles sold in the first nine months of 2013, compared with approximately 30% in the first nine months of 2012. "Online sales" includes the following: (i) selling vehicles directly from a dealership or other interim storage location (upstream selling); (ii) online solutions that offer vehicles for sale while in transit to auction locations (midstream selling); (iii) simultaneously broadcasting video and audio of the physical auctions to online bidders (LiveBlock®); and (iv) bulletin-board or real-time online auctions (DealerBlock®). Both the upstream and midstream selling represent "online only" sales, which represent approximately half of ADESA's online sales volume.

Revenue per vehicle sold decreased 2% as a result of a decrease in the utilization of ancillary services as a result of more vehicles being sold online as well as the change in mix of vehicles towards more dealer consignment cars sold at physical auction locations. Vehicles sold online and dealer consignment cars utilize fewer ancillary services than institutional vehicles sold at physical auction locations. The used vehicle conversion percentage at physical auction locations, calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale at our ADESA auctions, increased to 58.3% for the nine months ended September 30, 2013, compared with 57.8% for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, dealer consignment vehicles represented approximately 50% of used vehicles sold at ADESA physical auction locations, an increase from approximately 49% for the nine months ended September 30, 2012.

Gross Profit

For the nine months ended September 30, 2013, gross profit for ADESA increased $25.7 million, or 7%, to $374.5 million, compared with $348.8 million for the nine months ended September 30, 2012. Gross profit for ADESA was 44.4% of revenue for the nine months ended September 30, 2013, compared with 44.1% of revenue for the nine months ended September 30, 2012. The increase in gross profit percentage for the nine months ended September 30, 2013, compared with the nine months ended September 30, 2012, was primarily the result of the 7% increase in revenue. In addition, cost of services also benefited from the lower utilization of ancillary services as a result of increases in both vehicles sold online and dealer consignment cars.

Selling, General and Administrative

Selling, general and administrative expenses for the ADESA segment decreased $1.9 million, or 1%, to $187.7 million for the nine months ended September 30, 2013, compared with $189.6 million for the nine months ended September 30, 2012, primarily due to decreases in non-cash stock-based compensation expense, bad debt expense and travel expenses, partially offset by increases in incentive-based compensation and compensation expense.

IAA Results

	Nine Months Ended September 30,	
(Dollars in millions)	2013	2012
IAA revenue	$623.2	$534.1
Cost of services*	416.4	322.8
Gross profit*	206.8	211.3
Selling, general and administrative	59.5	52.7
Depreciation and amortization	55.4	50.8
Operating profit	$91.9	$107.8

* Exclusive of depreciation and amortization

Revenue

Revenue from IAA increased $89.1 million, or 17%, to $623.2 million for the nine months ended September 30, 2013, compared with $534.1 million for the nine months ended September 30, 2012. The increase in revenue was a result of an increase in vehicles sold of approximately 14% for the nine months ended September 30, 2013, as well as increases in revenue per vehicle sold. IAA's total loss vehicle inventory has increased over 15% at September 30, 2013, as compared to September 30, 2012. Vehicles sold under purchase agreements were approximately 7% of total salvage vehicles sold for the nine months ended September 30, 2013 and 2012. Online sales volumes for IAA for the nine months ended September 30, 2013 and 2012 represented approximately half of the total vehicles sold by IAA.

Gross Profit

For the nine months ended September 30, 2013, gross profit at IAA decreased to $206.8 million, or 33.2% of revenue, compared with $211.3 million, or 39.6% of revenue, for the nine months ended September 30, 2012. The gross profit decrease was primarily the result of the 29% increase in cost of services. The decrease in gross profit as a percentage of revenue was mainly attributable to an increase in expenses associated with processing total loss vehicles related to Superstorm Sandy, which included increases in towing costs, compensation expense, temporary rental property expense, travel expenses and miscellaneous yard and auction expenses, as well as increased costs associated with volume increases. An increase in the purchase price of vehicles sold under purchase agreements also contributed to the decrease in gross profit as a percentage of revenue, as the entire selling price of the vehicle is recorded as revenue and cost of services.

In the first nine months of 2013, IAA sold over 45,000 Superstorm Sandy vehicles resulting in revenue of approximately $29.7 million and cost of services of approximately $43.2 million. Overall, for the nine months ended September 30, 2013, IAA incurred a pre-tax net loss of $13.5 million related to the processing of Superstorm Sandy vehicles. Excluding the impact of revenues and expenses associated with Superstorm Sandy, the gross margin percentage for the first nine months of 2013 would have been 37.1% of revenue.

Selling, General and Administrative

Selling, general and administrative expenses at IAA increased $6.8 million, or 13%, to $59.5 million for the nine months ended September 30, 2013, compared with $52.7 million for the nine months ended September 30, 2012. The increase in selling, general and administrative expenses was attributable to increases in incentive-based compensation expense and information technology costs.

AFC Results

	Nine Months Ended September 30,	
(Dollars in millions except volumes and per loan amounts)	2013	2012
AFC revenue		
Interest and fee income	$156.5	$140.8
Other revenue	7.9	8.0
Provision for credit losses	(6.3)	(4.6)
Other service revenue	7.1	—
Total AFC revenue	165.2	144.2
Cost of services*	40.3	31.3
Gross profit*	124.9	112.9
Selling, general and administrative	18.2	16.1
Depreciation and amortization	20.3	17.6
Operating profit	$86.4	$79.2
Loan transactions	1,014,037	924,892
Revenue per loan transaction, excluding "Other service revenue"	$156	$156

* Exclusive of depreciation and amortization

Revenue

For the nine months ended September 30, 2013, AFC revenue increased $21.0 million, or 15%, to $165.2 million, compared with $144.2 million for the nine months ended September 30, 2012. The increase in revenue was the result of a 10% increase in loan transactions and $7.1 million of "Other service revenue" generated by Preferred Warranties, Inc. ("PWI"), for the nine months ended September 30, 2013, compared with the same period in 2012. PWI, a service contract business, was acquired in June 2013. In addition, managed receivables increased to $1,074.0 million at September 30, 2013 from $938.5 million at September 30, 2012.

Revenue per loan transaction, which includes both loans paid off and loans curtailed, was consistent with the prior year. An increase in the provision for credit losses was offset by increases in average loan values and average loan duration. Revenue per loan transaction excludes "Other service revenue."

Gross Profit

For the nine months ended September 30, 2013, gross profit for the AFC segment increased $12.0 million, or 11%, to $124.9 million, compared with $112.9 million for the nine months ended September 30, 2012, primarily as a result of a 15% increase in revenue, partially offset by a 29% increase in cost of services. The increase in cost of services was primarily the result of the inclusion of expenses associated with PWI, as well as increases in compensation expense.

Selling, General and Administrative

Selling, general and administrative expenses at AFC increased $2.1 million, or 13%, to $18.2 million, for the nine months ended September 30, 2013, compared with $16.1 million for the nine months ended September 30, 2012. The increase was primarily the result of expenses associated with PWI, as well as increases in professional fees and compensation expense, partially offset by decreases in stock-based compensation expense.

Holding Company Results

(Dollars in millions)	Nine Months Ended September 30, 2013	2012
Selling, general and administrative	$67.9	$61.5
Depreciation and amortization	3.4	1.4
Operating loss	$(71.3)	$(62.9)

Selling, General and Administrative

For the nine months ended September 30, 2013, selling, general and administrative expenses at the holding company increased $6.4 million, or 10%, to $67.9 million, compared with $61.5 million for the nine months ended September 30, 2012, primarily as a result of an increase in incentive-based compensation and other employee related expenses. For the nine months ended September 30, 2013, stock-based compensation expense related to the KAR LLC and Axle LLC operating and value units was $12.3 million, compared with $12.0 million for the nine months ended September 30, 2012. For the nine months ended September 30, 2013, approximately $8.2 million was paid to the KAR LLC profit interest holders and approximately $17.0 million was paid to the Axle LLC profit interest holders. The cash received by the profit interest holders was paid by KAR LLC and Axle LLC. None of the Company's cash was used to pay the profit interest holders.

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)	September 30, 2013	December 31, 2012	September 30, 2012
Cash and cash equivalents	$196.0	$108.7	$163.7
Restricted cash	9.1	11.9	7.7
Working capital	363.1	294.5	319.4
Amounts available under credit facility*	250.0	250.0	250.0
Cash flow from operations	318.4		238.0

* There were related outstanding letters of credit totaling approximately $23.6 million at September 30, 2013 and December 31, 2012, and $22.8 million at September 30, 2012, 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 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 $124.8 million at September 30, 2013. Of this amount, approximately $29.6 million was held by foreign subsidiaries. If the portion of funds held by our foreign subsidiaries that are considered to be permanently reinvested 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 independent used vehicle dealers. Financing is primarily provided for terms of 30 to 60 days. AFC principally generates its funding through the sale of its

32

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.

In March 2013, we entered into the Second Amendment to the Credit Agreement. The amendment increased Term Loan B $150.0 million to $1.8 billion and decreased the interest rate on Term Loan B to adjusted LIBOR plus 2.75% from adjusted LIBOR plus 3.75%. In addition, the adjusted LIBOR rate floor decreased to 1.0% from 1.25%. The interest rate on Term Loan B was 3.75% at September 30, 2013. For the nine months ended September 30, 2013, we recorded a $3.9 million pretax charge resulting from certain expenses related to the Credit Agreement amendment, as well as the write-off of certain unamortized debt issuance costs associated with the term loan. The additional $150.0 million in proceeds received from Term Loan B were used to redeem the floating rate senior notes due in 2014 on April 3, 2013. In the second quarter of 2013, we recorded a $0.8 million pretax charge primarily resulting from the write-off of unamortized debt issuance costs associated with the redemption of the floating rate senior notes.

Term Loan B is payable in quarterly installments equal to 0.25% of the aggregate principal amount as of the Second Amendment effective date, and commenced on March 31, 2013. The Credit Facility is subject to mandatory prepayments and reduction in an amount equal to (i) the net proceeds of certain debt offerings, asset sales and certain insurance recovery events; and (ii) for any fiscal year ending on or after December 31, 2011, any Excess Cash Flow, as defined in the Credit Agreement, on or before the 105^{th} day following the end of the fiscal year. In April 2013, the Company made an excess cash flow payment of $39.4 million for the year ended December 31, 2012. In addition, in accordance with the terms of the Credit Agreement, 50% of the net cash proceeds from the sale-leaseback of certain technology and capital equipment were used to prepay $5.2 million of Term Loan B in the first nine months of 2013. The prepayments were credited to prepay in order of maturity the unpaid amounts due on the next eight scheduled quarterly installments of Term Loan B, and thereafter to the remaining scheduled quarterly installments of Term Loan B on a pro rata basis. As such, after the debt prepayments, there are no further quarterly installments due until June 30, 2015.

On September 30, 2013, $1,775.3 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 $23.6 million at September 30, 2013, 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 September 30, 2013. However, there were related letters of credit outstanding totaling approximately C$1.2 million at September 30, 2013, which reduce credit available under the Canadian line of credit.

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 senior secured leverage ratio is calculated as total senior secured debt divided by the last four quarters consolidated Adjusted EBITDA. Senior secured debt includes term loan borrowings, revolving loans and capital lease liabilities less available cash as defined in the Credit Agreement. Consolidated Adjusted EBITDA 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) charges and revenue reductions resulting from purchase accounting; (g) minority interest; (h) expenses associated with the consolidation of salvage operations; (i) consulting expenses incurred for cost reduction, operating restructuring and business improvement efforts; (j) 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; (k) expenses incurred in connection with permitted acquisitions; (l) any impairment charges or write-offs of intangibles; and (m) any extraordinary, unusual or nonrecurring charges, expenses or losses.
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. Beginning with the quarter ended December 31,

2012 the ratio could not 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 March 31, 2016. Our actual consolidated senior secured leverage ratio was 3.2 to 1.0 at September 30, 2013.

In addition, the Credit Agreement contains certain financial and operational restrictions that 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 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 at September 30, 2013.

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 group of bank purchasers of undivided interests in certain eligible finance receivables subject to committed liquidity. AFC Funding Corporation had committed liquidity of $800 million for U.S. finance receivables at September 30, 2013.

In June 2013, AFC and AFC Funding Corporation entered into the Fifth Amended and Restated Receivables Purchase Agreement (the “Receivables Purchase Agreement”). The Receivables Purchase Agreement increased AFC Funding's U.S. committed liquidity from $650 million to $800 million and extended the facility's maturity date from June 30, 2014 to June 30, 2016. In addition, certain of the covenants and termination events in the Receivables Purchase Agreement that are tied to the performance of the finance receivables portfolio were modified. In the second quarter of 2013, we recorded a $0.7 million pretax charge primarily resulting from the write-off of unamortized securitization issuance costs associated with the amendment.

We also have an agreement for the securitization of Automotive Finance Canada Inc.'s (“AFCI”) receivables. In June 2013, AFCI entered into the Second Amended and Restated Receivables Purchase Agreement (the “Canadian Receivables Purchase Agreement”). The Canadian Receivables Purchase Agreement extended the facility's maturity date from June 30, 2014 to June 30, 2016. In addition, certain of the covenants and termination events in the Canadian Receivables Purchase Agreement that are tied to the performance of the finance receivables portfolio were modified. AFCI's committed liquidity is provided through a third party conduit (separate from the U.S. facility) and was C$100 million at September 30, 2013. 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 $1,074.0 million and $1,004.2 million at September 30, 2013 and December 31, 2012, respectively. AFC's allowance for losses was $8.0 million at September 30, 2013 and December 31, 2012.

As of September 30, 2013 and December 31, 2012, $1,065.1 million and $996.0 million, respectively, of finance receivables and a cash reserve of 1 percent of the obligations collateralized by finance receivables served as security for the $742.4 million and $713.3 million of obligations collateralized by finance receivables at September 30, 2013 and December 31, 2012, respectively. After the occurrence of a termination event, as defined in the U.S. securitization agreement, the banks may, and could, cause the stock of AFC Funding Corporation to be transferred to the bank facility, though as a practical matter the bank 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 facilities 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 September 30, 2013, we were in compliance with the covenants in the securitization agreements.

34

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:

	Three Months Ended September 30, 2013				
(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	$14.5	$13.8	$18.8	$(24.3)	$22.8
Add back:					
Income taxes	9.1	8.4	12.0	(9.9)	19.6
Interest expense, net of interest income	—	0.2	4.6	21.0	25.8
Depreciation and amortization	22.6	18.5	7.2	1.3	49.6
Intercompany interest	13.1	9.4	(5.6)	(16.9)	—
EBITDA	59.3	50.3	37.0	(28.8)	117.8
Adjustments per the Credit Agreement	4.6	—	(2.6)	10.8	12.8
Adjusted EBITDA	$63.9	$50.3	$34.4	$(18.0)	$130.6

	Three Months Ended September 30, 2012				
(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	$5.6	$12.2	$18.8	$(17.4)	$19.2
Add back:					
Income taxes	4.6	7.7	10.9	(9.4)	13.8
Interest expense, net of interest income	0.1	0.3	3.8	25.6	29.8
Depreciation and amortization	23.5	17.1	5.7	0.5	46.8
Intercompany interest	13.6	9.4	(4.6)	(18.4)	—
EBITDA	47.4	46.7	34.6	(19.1)	109.6
Adjustments per the Credit Agreement	7.0	(2.1)	(2.6)	5.4	7.7
Adjusted EBITDA	$54.4	$44.6	$32.0	$(13.7)	$117.3

	Nine Months Ended September 30, 2013				
(Dollars in millions)	ADESA	IAA	AFC	Corporate	Consolidated
Net income (loss)	$47.5	$39.3	$54.4	$(55.9)	$85.3
Add back:					
Income taxes	28.2	23.6	34.2	(26.5)	59.5
Interest expense, net of interest income	0.4	0.7	12.3	65.6	79.0
Depreciation and amortization	66.8	55.4	20.3	3.4	145.9
Intercompany interest	39.8	28.4	(15.2)	(53.0)	—
EBITDA	182.7	147.4	106.0	(66.4)	369.7
Adjustments per the Credit Agreement	15.2	0.7	(7.1)	15.0	23.8
Superstorm Sandy	—	&#16			