KAR Auction Services, Inc.
Form 10-Q
August 04, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2010

OR

¨ **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	**20-8744739**
(State or other jurisdiction of incorporation or organization)	**(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 x No ¨

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 ¨ No ¨

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

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

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

As of July 31, 2010, 134,745,535 shares of the registrant s common stock, par value $0.01 per share, were outstanding.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

KAR Auction Services, Inc.

Consolidated Statements of Income

(In millions)

(Unaudited)

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating revenues				
ADESA Auction Services	**$ 280.1**	$ 279.5	**$ 553.7**	$ 567.8
IAAI Salvage Services	**157.3**	139.0	**316.1**	277.0
AFC	**32.6**	20.6	**58.6**	36.8
Total operating revenues	**470.0**	439.1	**928.4**	881.6
Operating expenses				
Cost of services (exclusive of depreciation and amortization)	**251.7**	246.6	**507.7**	515.5
Selling, general and administrative	**90.8**	87.1	**185.8**	172.9
Depreciation and amortization	**41.8**	42.3	**85.1**	88.3
Total operating expenses	**384.3**	376.0	**778.6**	776.7
Operating profit	**85.7**	63.1	**149.8**	104.9
Interest expense	**35.9**	46.9	**70.8**	93.5
Other (income) expense, net	**1.3**	(6.2)	**(1.6)**	(4.5)
Loss on extinguishment of debt			**25.3**	
Income before income taxes	**48.5**	22.4	**55.3**	15.9
Income taxes	**19.9**	9.6	**18.6**	6.6
Net income	**$ 28.6**	$ 12.8	**$ 36.7**	$ 9.3
Net income per share basic and diluted	**$ 0.21**	$ 0.12	**$ 0.27**	$ 0.09

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions)

	June 30, 2010 *(unaudited)*	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	**$ 289.4**	$ 363.9
Restricted cash	**8.3**	9.3
Trade receivables, net of allowances of $6.3 and $6.9	**346.1**	250.4
Finance receivables, net of allowances	**112.9**	150.3
Finance receivables securitized, net of allowances	**571.2**	
Retained interests in finance receivables sold		89.8
Deferred income tax assets	**42.6**	37.3
Other current assets	**46.4**	40.9
Total current assets	**1,416.9**	941.9
Other assets		
Goodwill	**1,528.3**	1,528.1
Customer relationships, net of accumulated amortization of $217.1 and $182.7	**717.2**	753.3
Other intangible assets, net of accumulated amortization of $78.0 and $62.9	**263.8**	266.8
Unamortized debt issuance costs	**48.3**	61.6
Other assets	**12.9**	16.4
Total other assets	**2,570.5**	2,626.2
Property and equipment, net of accumulated depreciation of $266.9 and $233.4	**666.3**	683.2
Total assets	**$ 4,653.7**	$ 4,251.3

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions, except share data)

	June 30, 2010 (unaudited)	December 31, 2009
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	**$ 408.3**	$ 262.7
Accrued employee benefits and compensation expenses	**51.4**	56.4
Accrued interest	**11.6**	14.8
Other accrued expenses	**77.6**	80.2
Income taxes payable	**3.1**	2.7
Obligations collateralized by finance receivables	**473.4**	
Current maturities of long-term debt		225.6
Total current liabilities	**1,025.4**	642.4
Non-current liabilities		
Long-term debt	**2,019.0**	2,047.3
Deferred income tax liabilities	**323.6**	328.2
Other liabilities	**109.7**	91.9
Total non-current liabilities	**2,452.3**	2,467.4
Commitments and contingencies (Note 12)		
Stockholders equity		
Preferred stock, $0.01 par value:		
Authorized shares: 100,000,000 Issued shares: none		
Common stock, $0.01 par value:		
Authorized shares: 400,000,000		
Issued and outstanding shares:		
June 30, 2010: 134,672,003		
December 31, 2009: 134,509,710	**1.4**	1.4
Additional paid-in capital	**1,363.7**	1,355.2
Retained deficit	**(197.8)**	(234.5)
Accumulated other comprehensive income	**8.7**	19.4
Total stockholders equity	**1,176.0**	1,141.5
Total liabilities and stockholders equity	**$ 4,653.7**	$ 4,251.3

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Statement of Stockholders Equity

(In millions)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2009	134.5	$ 1.4	$ 1,355.2	($ 234.5)	$ 19.4	$ 1,141.5
Comprehensive income:						
Net income				36.7		36.7
Other comprehensive income (loss), net of tax:						
Unrealized loss on interest rate derivatives					(5.8)	(5.8)
Foreign currency translation					(4.9)	(4.9)
Comprehensive income				36.7	(10.7)	26.0
Issuance of common stock under stock plans	0.2		1.3			1.3
Stock-based compensation expense			7.2			7.2
Balance at June 30, 2010	**134.7**	**$ 1.4**	**$ 1,363.7**	**($ 197.8)**	**$ 8.7**	**$ 1,176.0**

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Operating activities		
Net income	**$ 36.7**	$ 9.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**85.1**	88.3
Provision for credit losses	**6.3**	1.4
Deferred income taxes	**(3.7)**	(7.0)
Amortization of debt issuance costs	**6.9**	6.8
Stock-based compensation	**7.2**	0.9
Loss (gain) on disposal of fixed assets	**0.4**	(0.2)
Loss on extinguishment of debt	**25.3**	
Other non-cash, net	**6.9**	3.9
Changes in operating assets and liabilities, net of acquisitions:		
Finance receivables held for sale	**50.2**	26.5
Retained interests in finance receivables sold	**89.8**	(22.5)
Trade receivables and other assets	**(103.8)**	(28.4)
Accounts payable and accrued expenses	**120.6**	62.9
Net cash provided by operating activities	**327.9**	141.9
Investing activities		
Net increase in finance receivables held for investment	**(589.9)**	(1.8)
Acquisition of businesses, net of cash acquired	**(2.6)**	(3.4)
Purchases of property, equipment and computer software	**(22.0)**	(27.4)
Proceeds from the sale of property and equipment	**1.8**	0.2
Decrease in restricted cash	**1.0**	2.1
Net cash used by investing activities	**(611.7)**	(30.3)
Financing activities		
Net increase in book overdrafts	**8.7**	1.4
Net decrease in borrowings from lines of credit		(4.5)
Payments for debt issuance costs		(0.3)
Net increase in obligations collateralized by finance receivables	**473.4**	
Payments on long-term debt	**(28.3)**	
Payment for early extinguishment of debt	**(243.6)**	
Payments on capital leases	**(2.3)**	(1.4)
Initial net investment for interest rate cap		(1.3)
Issuance of common stock under stock plans	**1.5**	
Net cash provided by (used by) financing activities	**209.4**	(6.1)
Effect of exchange rate changes on cash	**(0.1)**	0.2
Net increase (decrease) in cash and cash equivalents	**(74.5)**	105.7
Cash and cash equivalents at beginning of period	**363.9**	158.4

Cash and cash equivalents at end of period	**$ 289.4**	$ 264.1

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements

June 30, 2010 (Unaudited)

Note 1 Basis of Presentation and Nature of Operations

Defined Terms

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

- we, us, our, KAR Auction Services and the Company refer, collectively, to KAR Auction Services, Inc. (formerly known as KAR Holdings, Inc.) and all of its subsidiaries unless the context otherwise requires;
- ADESA refers, collectively, to ADESA, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries;
- AFC refers, collectively, to Automotive Finance Corporation, a wholly owned subsidiary of ADESA and its subsidiaries;
- Credit Agreement refers to the Credit Agreement, dated April 20, 2007, among KAR Auction Services, as the borrower, KAR LLC, as guarantor, the several lenders from time to time parties thereto and the administrative agent, the joint bookrunners, the co-documentation agents, the syndication agent and the joint lead arrangers named therein, as amended on June 10, 2009, October 23, 2009 and from time to time;
- Equity Sponsors refers, collectively, to Kelso Investment Associates VII, L.P., GS Capital Partners VI, L.P., ValueAct Capital Master Fund, L.P. and Parthenon Investors II, L.P., which collectively own through their respective affiliates a majority of the equity of KAR Auction Services;
- IAAI refers, collectively, to Insurance Auto Auctions, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries; and
- KAR LLC refers to KAR Holdings II, LLC, which is owned by affiliates of the Equity Sponsors and management of the Company.

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 necessary, generally consisting of normal recurring accruals, for a fair statement of our financial results for the periods presented. In preparing the accompanying financial statements, management has evaluated subsequent events through the date the financial statements were issued. 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. A listing of our critical accounting estimates is described in the Critical Accounting Estimates section of Management s Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission (SEC) on February 25, 2010 (File No:

001-34568), which includes audited financial statements.

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

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 for the year ended December 31, 2009 included in our Annual Report on Form 10-K for the year ended December 31, 2009. The 2009 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.

Nature of operations

As of June 30, 2010, we have a network of 62 ADESA whole car auctions and 157 IAAI salvage vehicle auctions which facilitates the sale of used and salvage vehicles through physical, online or hybrid auctions, and which permit Internet buyers to participate in physical auctions. ADESA Auctions and IAAI are leading, national providers of wholesale and salvage vehicle auctions and related vehicle redistribution services for the automotive industry in North America. Redistribution 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 IAAI facilitate the exchange of these vehicles through an auction marketplace, which aligns sellers and buyers. As an agent for customers, the companies generally do not take title to or ownership to substantially all 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 logistics, reconditioning, vehicle inspection and certification, titling, administrative and salvage recovery services. ADESA is able to serve the diverse and multi-faceted needs of its customers through the wide range of services offered at its facilities.

IAAI is one of the two largest providers of salvage vehicle auctions and related services in North America. The salvage auctions facilitate the redistribution 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 and older model vehicles donated to charity or sold by dealers in salvage auctions. The salvage auction business specializes in providing services such as inbound and outbound logistics, inspections, evaluations, titling and settlement administrative services.

AFC is a leading provider of floorplan financing to independent used vehicle dealers and this financing is provided through 88 loan production offices located throughout North America. Floorplan financing supports independent used vehicle dealers in North America who purchase vehicles at ADESA, IAAI, independent auctions and auctions affiliated with other auction networks.

Note 2 Accounting Change as a Result of the Adoption of Accounting Standards Update 2009-16

In December 2009, the Financial Accounting Standards Board (FASB) issued new guidance (Accounting Standards Update 2009-16) on the accounting for transfers of financial assets. The new guidance which is now a part of ASC 860, *Transfers and Servicing*, eliminates the concept of a qualifying special-purpose entity, creates more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria and changes the initial measurement of a transferor s interest in transferred financial assets. The new guidance is effective on a prospective basis for annual periods beginning after November 15, 2009. This new guidance requires inclusion of loans sold to a bank conduit facility as well as the related obligation originated after December 31, 2009, in our financial statements. We adopted the guidance on January 1, 2010. This resulted in an increase in assets and related obligations in 2010. Obligations collateralized by finance

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

receivables were $473.4 million at June 30, 2010. In addition, the new guidance eliminated securitization income accounting and resulted in the recording of fee and interest income and interest expense for the finance receivable transactions under the revolving sale agreement. The elimination of securitization income accounting resulted in a reduction of pre-tax income of approximately $2.8 million in the first quarter of 2010. See Note 6 for additional information.

Note 3 New Accounting Standards

In February 2010, the FASB issued new guidance (Accounting Standards Update 2010-06) on fair value measurements. The new guidance, which is now a part of ASC 820, *Fair Value Measurements and Disclosures,* requires disclosure of details of significant transfers in and out of Level 1 and Level 2 measurements and reasons for the transfers. In addition, a gross presentation of activity within the Level 3 roll forward, presenting separately information about purchases, sales, issuances and settlements is required. The new guidance is effective for the first interim or annual reporting period beginning after December 15, 2009, with the exception for the gross presentation of the Level 3 roll forward, which is required for annual reporting periods beginning after December 15, 2010 and for interim reporting periods within those years. The adoption of the new guidance did not have a material impact on the consolidated financial statements.

In February 2010, the FASB issued new guidance (Accounting Standards Update 2010-09) on subsequent events. The new guidance, which is now a part of ASC 855, *Subsequent Events*, requires an SEC filer to evaluate subsequent events through the date that the financial statements are issued. An entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. The new guidance was immediately effective upon issuance of the final update. The adoption of the new guidance did not have a material impact on the consolidated financial statements.

Note 4 Stock-Based Compensation Plans

We adopted the KAR Auction Services, Inc. 2009 Omnibus and Stock Incentive Plan (Omnibus Plan) in December 2009. The Omnibus Plan is intended to provide equity or cash based awards to our employees. On March 1, 2010, we granted approximately 0.3 million service options and 0.7 million exit options with an exercise price of $13.46 per share under the Omnibus Plan. The options have a ten year life. The service options vest in four equal annual installments, commencing on the first anniversary of the grant date. The exit options vest as follows:

Amount Vested	**Conditions to Vesting**
25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $20.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $25.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $30.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $35.00*

* Additional conditions to vesting: (ii) the price of the Company s common stock on the last trading day of a 90 consecutive trading day period must be greater than or equal to 85% of $20.00, $25.00, $30.00 or $35.00, respectively; and (iii) the option holder is a director, officer, employee, consultant or agent of the Company or any of its subsidiaries on the date on which the conditions set forth in (i) and (ii) above are satisfied.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

For purposes of determining the conditions to vesting, the fair market value of any share of Company common stock, on any date of determination, shall be the average for 90 consecutive trading days prior to such date of determination of the last sales price for a share of Company common stock on the principal securities exchange on which the Company common stock is then listed.

Our stock-based compensation expense includes expenses associated with KAR Auction Services, Inc. service and exit option awards, KAR LLC operating unit awards and Axle Holdings II, LLC (LLC) operating unit awards. We have classified the KAR LLC and LLC operating units as liability awards. We have classified the KAR Auction Services, Inc. service and exit options as equity awards. The main difference between a liability-classified award and an equity-classified award is that liability-classified awards are remeasured each reporting period at fair value.

The compensation cost that was charged against income for all stock-based compensation plans was $0.4 million and $7.2 million for the three and six months ended June 30, 2010, respectively, and the total income tax benefit recognized in the Consolidated Statement of Income for options was approximately $1.6 million and $3.2 million for the three and six months ended June 30, 2010, respectively. The compensation cost that was charged against income for all stock-based compensation plans was $0.5 million and $0.9 million for the three and six months ended June 30, 2009, respectively, and the total income tax benefit recognized in the Consolidated Statement of Income for options was approximately $0.1 million and $0.3 million for the three and six months ended June 30, 2009, respectively. We did not capitalize any stock-based compensation cost in the six months ended June 30, 2010 or 2009.

KAR Auction Services, Inc. Employee Stock Purchase Plan

Our board of directors and stockholders adopted the KAR Auction Services, Inc. Employee Stock Purchase Plan (ESPP) in December 2009 and the ESPP was implemented in the second quarter of 2010. A maximum of 1,000,000 shares of our common stock have been reserved for issuance under the ESPP and at June 30, 2010, 981,103 shares remain available for purchase under the ESPP. The ESPP provides for one month offering periods with a 15% discount from the fair market value of a share on the date of purchase. A participant s combined payroll deductions and cash payments in the ESPP may not exceed $25,000 per year.

Note 5 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 June 30,		Six Months Ended June 30,	
	2010	**2009**	**2010**	**2009**
Net income	**$ 28.6**	$ 12.8	**$ 36.7**	$ 9.3
Weighted average common shares outstanding	**134.6**	106.9	**134.6**	106.9
Effect of dilutive stock options	**1.5**		**1.4**	
Weighted average common shares outstanding and potential common shares	**136.1**	106.9	**136.0**	106.9
Net income per share basic and diluted	**$ 0.21**	$ 0.12	**$ 0.27**	$ 0.09

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

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 share are excluded from the calculations. Approximately 0.6 million options were excluded from the calculation of diluted net income per share for the three and six months ended June 30, 2010. Total options outstanding at June 30, 2010 and 2009 were 10.0 million and 9.2 million.

Note 6 Finance Receivables and Obligations Collateralized by Finance Receivables

AFC sells the majority of its U.S. dollar denominated finance receivables on a revolving basis and without recourse to a wholly owned, bankruptcy remote, consolidated, special purpose subsidiary (AFC Funding Corporation), established for the purpose of purchasing AFC s finance receivables. A securitization agreement allows for the revolving sale by AFC Funding Corporation to a bank conduit facility in undivided interests in certain eligible finance receivables subject to committed liquidity. The agreement expires on April 20, 2012. AFC Funding Corporation had committed liquidity of $450 million for U.S. finance receivables at June 30, 2010.

We completed an agreement for the securitization of Automotive Finance Canada, Inc. s (AFCI) receivables in February 2010. This securitization facility provides up to C$75 million in financing for eligible finance receivables. The initial funding for securitization of Canadian finance receivables resulted in net proceeds of $56.6 million and the recording of the related obligations. The agreement expires on April 20, 2012.

Accounting Standards Update 2009-16 amended ASC 860, *Transfers and Servicing*, and we adopted the new guidance on January 1, 2010. The new guidance specifies that the finance receivable transactions on or subsequent to January 1, 2010 under our revolving sale agreement be included in our balance sheet. This resulted in an increase in assets and related obligations in 2010. Obligations collateralized by finance receivables were $473.4 million at June 30, 2010. In addition, the new guidance eliminated securitization income accounting and resulted in the recording of fee and interest income and interest expense for the finance receivable transactions under the revolving sale agreement. The elimination of securitization income accounting resulted in a reduction of pre-tax income of approximately $2.8 million in the first quarter of 2010.

The following illustration 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.

	June 30, 2010 Principal Amount of:		**Net Credit Losses**	**Net Credit Losses**
(in millions)	**Receivables**	**Receivables Delinquent**	**Three Months Ended June 30, 2010**	**Six Months Ended June 30, 2010**
Floorplan receivables	**$ 685.6**	**$ 1.7**	**$ 1.8**	**$ 4.5**
Special purpose loans	**9.0**	**2.9**		
Total receivables managed	**$ 694.6**	**$ 4.6**	**$ 1.8**	**$ 4.5**

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

	December 31, 2009 Principal Amount of:		Net Credit Losses	Net Credit Losses
(in millions)	**Receivables**	**Receivables Delinquent**	**Three Months Ended June 30, 2009**	**Six Months Ended June 30, 2009**
Floorplan receivables	$ 145.9	$ 1.6	$ 0.8	$ 1.0
Special purpose loans	10.3	3.4		
Finance receivables held	$ 156.2	$ 5.0	$ 0.8	$ 1.0
Receivables sold	367.0			
Retained interests in finance receivables sold	89.8			
Total receivables managed	$ 613.0			

The net credit losses for receivables sold approximated $6.3 million and $18.1 million for the three and six months ended June 30, 2009.

At June 30, 2010, AFC managed total finance receivables of $694.6 million. At December 31, 2009, AFC managed total finance receivables of $613.0 million, of which $519.1 million had been sold without recourse to AFC Funding Corporation. Undivided interests in finance receivables were sold by AFC Funding Corporation to the bank conduit facility with recourse totaling $367.0 million at December 31, 2009. Finance receivables include $24.6 million classified as held for sale, which are recorded at lower of cost or fair value, and $131.6 million classified as held for investment at December 31, 2009. Finance receivables classified as held for investment include $25.7 million related to receivables that were sold to the bank conduit facility that were repurchased by AFC at fair value when they became ineligible under the terms of the collateral agreement with the bank conduit facility at December 31, 2009. The face amount of these receivables was $27.5 million at December 31, 2009.

AFC s allowance for losses of $10.5 million and $5.9 million at June 30, 2010 and December 31, 2009 includes an estimate of losses for finance receivables held for investment as well as an allowance for any further deterioration in the finance receivables after they are repurchased from the bank conduit facility. Additionally, accrued liabilities of $2.4 million for the estimated losses for loans sold by the special purpose subsidiary were recorded at December 31, 2009. These loans were sold to a bank conduit facility with recourse to the special purpose subsidiary and came back on the balance sheet of the special purpose subsidiary at fair market value when they became ineligible under the terms of the collateral arrangement with the bank conduit facility.

As of December 31, 2009, the outstanding receivables sold, the retained interests in finance receivables sold and a cash reserve of 1 or 3 percent of total sold receivables serve as security for the receivables that have been sold to the bank conduit facility. As of June 30, 2010, $685.0 million of finance receivables and a cash reserve of 1 or 3 percent of finance receivables securitized serve as security for the $473.4 million of obligations collateralized by finance receivables. The amount of the cash reserve depends on circumstances which are set forth in the securitization agreements. After the occurrence of a termination event, as defined in the U.S. securitization agreement, the bank conduit facility may, and could, cause the stock of AFC Funding Corporation to be transferred to the bank conduit facility, though as a practical matter the bank conduit facility would look to the liquidation of the receivables under the transaction documents as their primary remedy.

Proceeds from the revolving sale of receivables to the bank conduit facility are used to fund new loans to customers. AFC, AFC Funding Corporation and AFCI must maintain certain financial covenants including, among others, limits on the amount of debt AFC and AFCI can incur, minimum levels of tangible net worth, and

KAR Auction Services, Inc.

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other covenants tied to the performance of the finance receivables portfolio. The securitization agreements also incorporate the financial covenants of our credit facility. At June 30, 2010, we were in compliance with the covenants in the securitization agreements.

The following table summarizes certain cash flows received from and paid to the special purpose subsidiaries (*in millions*):

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Proceeds from sales of finance receivables	**N/A**	$ 1,440.2
Servicing fees received	**N/A**	$ 4.9
Proceeds received on retained interests in finance receivables sold	**$ 89.8**	$ 35.9

Our retained interests in finance receivables sold, including a nominal interest only strip, amounted to $89.8 million at December 31, 2009. Sensitivities associated with our retained interests were insignificant at all periods presented due to the short-term nature of the asset.

Note 7 Long-Term Debt

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

	Interest Rate	Maturity	June 30, 2010	December 31, 2009
Term Loan B	LIBOR + 2.75%	October 19, 2013	**$ 1,219.6**	$ 1,247.9
$250 million revolving credit facility	LIBOR + 2.75%	April 19, 2013		
Floating rate senior notes	LIBOR + 4.00%	May 01, 2014	**150.0**	150.0
Senior notes	8.75%	May 01, 2014	**450.0**	450.0
Senior subordinated notes	10%	May 01, 2015	**199.4**	425.0
Canadian line of credit	CAD Prime + 1.5%			
Total debt			**2,019.0**	2,272.9
Less current portion of long-term debt				225.6
Long-term debt			**$ 2,019.0**	$ 2,047.3

Credit Facilities

In 2007, we entered into senior secured credit facilities, comprised of a $300.0 million revolving credit facility and a $1,565.0 million term loan (Term Loan B in the table above). The revolver was entered into for working capital and general corporate purposes. In 2009, we entered into an amendment to the Credit Agreement. As part of the amendment, available borrowings under the revolving credit facility were reduced to $250 million and the revolving credit facility and Term Loan B interest rate were increased to LIBOR plus a margin of 2.75% from LIBOR plus a margin of 2.25%. There were no borrowings under the revolving credit facility at June 30, 2010 or December 31, 2009, although we had related outstanding letters of credit in the aggregate amount of $32.7 million and $31.7 million at June 30, 2010 and December 31, 2009, respectively, which reduce the amount available for borrowings under our credit facility.

As part of the amendment to the Credit Agreement, we prepaid $250 million of the term loan in the fourth quarter of 2009 using proceeds from the initial public offering as well as cash on hand. In addition, in accordance with terms of the Credit Agreement, 50% of the net proceeds from the initial sale of AFC s Canadian receivables,

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as discussed in Note 6, were used to repay $28.3 million of the Company s term loan in February 2010. The prepayments were credited to prepay in direct order of maturity the unpaid amounts due on the next eight scheduled quarterly installments of the term loan, and thereafter to the remaining scheduled quarterly installments of the term loan on a pro rata basis. As such, there are no further scheduled quarterly installments due on the term loan and the remaining balance is due at maturity (October 19, 2013). If there is any excess cash flow, as defined in the loan documents for our senior secured credit facility, we are required to prepay the term loan in an amount equal to 50% of the excess cash flow on or before the 105^{th} day following the end of the fiscal year. There were no excess cash flow payments, as defined, due for the year ended December 31, 2009.

The senior secured credit facilities are guaranteed by KAR Auction Services and each of our direct and indirect present and future material domestic subsidiaries, subject to certain exceptions (excluding among others, AFC Funding Corporation). The senior secured credit facilities are secured by a perfected first priority security interest in, and mortgages on, all present and future tangible and intangible assets of the Company and the guarantors, and our capital stock and that of each of our direct and indirect material domestic subsidiaries and 65% of the capital stock of certain foreign subsidiaries.

The terms of the Credit Agreement include a 0.5% commitment fee based on unutilized amounts, letter of credit fees and agency fees. The Credit Agreement also includes covenants that, among other things, limit or restrict us and our subsidiaries abilities to dispose of assets, incur additional indebtedness, incur guarantee obligations, prepay other indebtedness, including the senior notes, pay dividends, create liens, make equity or debt investments, make acquisitions, modify the terms of the indenture, engage in mergers, make capital expenditures and engage in certain transactions with affiliates. In addition, the senior secured credit facilities are subject to a senior secured leverage ratio test, provided there are revolving loans outstanding. There were no revolving loans outstanding at June 30, 2010. We were in compliance with the covenants in the credit facility at June 30, 2010.

Senior Notes

In 2007, we issued $450.0 million of 8.75% senior notes and $150.0 million of floating rate senior notes both of which are due May 1, 2014. In addition, we issued $425.0 million of 10% senior subordinated notes due May 1, 2015. In connection with our initial public offering, we conducted a cash tender offer for certain of the notes described above. The tender offer was oversubscribed and as such, in accordance with the identified priority levels, only a portion of the 10% senior subordinated notes were accepted for prepayment. In January 2010, we prepaid $225.6 million principal amount of the 10% senior subordinated notes with proceeds received from the initial public offering and the underwriters option to purchase additional shares. This amount was included in Current maturities of long-term debt on the consolidated balance sheet at December 31, 2009. We incurred a loss on the extinguishment of the notes of $25.3 million in the first quarter of 2010.

Fair Value of Debt

As of June 30, 2010, the estimated fair value of our long-term debt amounted to $1,951.5 million. The estimates of fair value are based on the market prices for our publicly-traded debt as of June 30, 2010. The estimates presented on long-term financial instruments are not necessarily indicative of the amounts that would be realized in a current market exchange.

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Note 8 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. Our July 2007 interest rate swap agreement with a notional amount of $800 million matured on June 30, 2009. In May 2009, we entered into an interest rate swap agreement with a notional amount of $650 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility. The interest rate swap agreement had an effective date of June 30, 2009, matures on June 30, 2012 and effectively results in a fixed LIBOR interest rate of 2.19% on $650 million of the Term Loan B credit facility. We are exposed to credit loss in the event of non-performance by the counterparty; however, non-performance is not anticipated.

In May 2009, we also purchased an interest rate cap for $1.3 million with a notional amount of $250 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility when one-month LIBOR exceeds 2.5%. The interest rate cap relates to a portion of the variable rate debt that is not covered by our interest rate swap agreement. The interest rate cap agreement had an effective date of June 30, 2009 and matures on June 30, 2011. The unamortized portion of the $1.3 million investment is recorded in Other current assets on the consolidated balance sheet and is being amortized over the remaining life of the interest rate cap to interest expense. We are exposed to credit loss in the event of non-performance by the counterparty; however, non-performance is not anticipated.

ASC 815 requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. In accordance with ASC 815, we have designated our interest rate derivatives as cash flow hedges. The fair values of the interest rate derivatives are based on quoted market prices for similar instruments from a commercial bank and represent the estimated amounts we would receive or pay to terminate the agreements at the reporting date. The following table presents the fair value of our interest rate derivatives included in the consolidated balance sheet for the periods presented (*in millions*):

Derivatives Designated as Hedging	Asset Derivatives				Liability Derivatives			
	June 30, 2010		December 31, 2009		June 30, 2010		December 31, 2009	
Instruments Under ASC 815	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
$650 million notional interest rate swap	Other assets	$	Other assets	$	Other accrued expenses	$ 17.9	Other accrued expenses	$ 8.7
$250 million notional interest rate cap	Other current assets	$	Other assets	$ 0.6	Other accrued expenses	$	Other accrued expenses	$

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The earnings impact of the interest rate derivatives designated as cash flow hedges are recorded upon the recognition of the interest related to the hedged debt. Any ineffectiveness in the hedging relationships is recognized in current earnings. There was no significant ineffectiveness in the first six months of 2010 or 2009. Unrealized gains or losses on the interest rate derivatives are included as a component of Accumulated other comprehensive income. At June 30, 2010, there was a net unrealized loss totaling $11.5 million, net of tax benefits of $7.0 million. At December 31, 2009, there was a net unrealized loss totaling $5.7 million, net of tax benefits of $3.5 million. The following table presents the effect of the interest rate derivatives on our statement of equity and consolidated statements of income for the periods presented (*in millions*):

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended June 30, 2010	2009	Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended June 30, 2010	2009
$800 million notional interest rate swap	**N/A**	$ 8.3	Interest expense	**N/A**	($ 8.3)
$650 million notional interest rate swap	**($ 3.9)**	($ 3.7)	Interest expense	**($ 3.1)**	$
$250 million notional interest rate cap	**$ 0.1**	$	N/A	**$**	$

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion) Six Months Ended June 30, 2010	2009	Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Six Months Ended June 30, 2010	2009
$800 million notional interest rate swap	**N/A**	$ 16.3	Interest expense	**N/A**	($ 16.1)
$650 million notional interest rate swap	**($ 9.2)**	($ 3.7)	Interest expense	**($ 6.3)**	$
$250 million notional interest rate cap	**($ 0.2)**	$	N/A	**$**	$

Note 9 Comprehensive Income

The components of comprehensive income are as follows (*in millions*):

	Three Months Ended June 30, 2010	2009	Six Months Ended June 30, 2010	2009
Net income	**$ 28.6**	$ 12.8	**$ 36.7**	$ 9.3
Other comprehensive income (loss), net of tax				
Foreign currency translation gain (loss)	**(11.3)**	17.8	**(4.9)**	10.2
Unrealized gain (loss) on interest rate deriviatives	**(2.4)**	2.9	**(5.8)**	8.0

Comprehensive income	**$ 14.9**	$ 33.5	**$ 26.0**	$ 27.5

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June 30, 2010 (Unaudited)

The composition of Accumulated other comprehensive income at June 30, 2010, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $11.5 million, a $0.3 million unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $19.9 million. The composition of Accumulated other comprehensive income at December 31, 2009, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $5.7 million, a $0.3 million unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $24.8 million.

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 the assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include instruments for which the determination of fair value requires significant management judgment or estimation.

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

Description	**June 30, 2010**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Liabilities:				
Interest rate swap	**$ 17.9**	**$**	**$ 17.9**	**$**

Description	**December 31, 2009**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**

Assets:								
Retained interest	$	89.8	$		$		$	89.8
Interest rate cap		0.6				0.6		
Liabilities:								
Interest rate swap	$	8.7	$		$	8.7	$	

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

June 30, 2010 (Unaudited)

Retained Interest The fair value of the retained interests in finance receivables sold prior to January 1, 2010 was based upon our estimates of future cash flows, using assumptions that market participants would use to value such investments, including estimates of anticipated credit losses over the life of the finance receivables sold. The cash flows were discounted using a market discount rate. The recorded fair value, however, required significant management judgment or estimation and may not necessarily have represented what we would have received in an actual sale of the receivables.

Interest Rate Swap Under the interest rate swap agreement, we pay a fixed LIBOR rate on a notional amount and receive a variable LIBOR rate which effectively hedges a portion of the Term Loan B credit facility. The fair value of the interest rate swap is based on quoted market prices for similar instruments from a commercial bank.

Interest Rate Cap Under the interest rate cap agreement, we will receive interest on a notional amount when one-month LIBOR exceeds 2.5%. This agreement effectively hedges a portion of the Term Loan B credit facility. The fair value of the interest rate cap is based on quoted market prices for similar instruments from a commercial bank.

Note 11 Segment Information

ASC 280, *Segment Reporting,* requires reporting of segment information that is consistent with the manner in which the chief operating decision maker operates and views the Company. We have three reportable business segments: ADESA Auctions, IAAI and AFC. These reportable segments offer different services and are managed separately based on the 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 incremental insurance, treasury, legal and risk management costs. Holding company interest expense includes the interest expense incurred on the corporate debt structure. Intercompany charges relate primarily to interest on intercompany debt or receivables and certain information technology costs allocated by the holding company.

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Financial information regarding our reportable segments is set forth below for the three months ended June 30, 2010 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 280.1	$ 157.3	$ 32.6	$	$ 470.0
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	152.8	91.8	7.1		251.7
Selling, general and administrative	54.0	20.0	4.7	12.1	90.8
Depreciation and amortization	20.9	14.6	6.2	0.1	41.8
Total operating expenses	227.7	126.4	18.0	12.2	384.3
Operating profit (loss)	52.4	30.9	14.6	(12.2)	85.7
Interest expense	0.3	0.6	1.8	33.2	35.9
Other (income) expense, net	(0.2)	(0.2)		1.7	1.3
Intercompany expense (income)	10.5	9.6	(3.3)	(16.8)	
Income (loss) before income taxes	41.8	20.9	16.1	(30.3)	48.5
Income taxes	15.2	7.9	6.2	(9.4)	19.9
Net income (loss)	$ 26.6	$ 13.0	$ 9.9	($ 20.9)	$ 28.6
Assets	$ 2,264.0	$ 1,195.7	$ 1,117.3	$ 76.7	$ 4,653.7

Financial information regarding our reportable segments is set forth below for the three months ended June 30, 2009 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 279.5	$ 139.0	$ 20.6	$	$ 439.1
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	153.0	86.3	7.3		246.6
Selling, general and administrative	52.3	15.7	2.8	16.3	87.1
Depreciation and amortization	21.5	14.5	6.1	0.2	42.3
Total operating expenses	226.8	116.5	16.2	16.5	376.0
Operating profit (loss)	52.7	22.5	4.4	(16.5)	63.1
Interest expense	0.2	0.3		46.4	46.9
Other (income) expense, net	(1.2)	(1.0)	1.2	(5.2)	(6.2)
Intercompany expense (income)	9.7	10.6	(2.0)	(18.3)	

Income (loss) before income taxes	44.0	12.6	5.2	(39.4)	22.4
Income taxes	17.2	5.1	1.6	(14.3)	9.6
Net income (loss)	$ 26.8	$ 7.5	$ 3.6	($ 25.1)	$ 12.8
Assets	$ 2,195.9	$ 1,150.6	$ 637.1	$ 255.7	$ 4,239.3

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Financial information regarding our reportable segments is set forth below for the six months ended June 30, 2010 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company