KAR Auction Services, Inc.
Form 10-Q
May 04, 2011
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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 March 31, 2011

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	**(I.R.S. Employer**
incorporation or organization)	**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 x Non-accelerated filer ¨ 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 April 30, 2011, 135,897,929 shares of the registrant s common stock, par value $0.01 per share, were outstanding.

KAR Auction Services, Inc.

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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 March 31, 2011	2010
Operating revenues		
ADESA Auction Services	**$ 268.3**	$ 273.6
IAAI Salvage Services	**175.9**	158.8
AFC	**38.5**	26.0
Total operating revenues	**482.7**	458.4
Operating expenses		
Cost of services (exclusive of depreciation and amortization)	**263.1**	256.0
Selling, general and administrative	**102.1**	95.0
Depreciation and amortization	**44.1**	43.3
Total operating expenses	**409.3**	394.3
Operating profit	**73.4**	64.1
Interest expense	**33.2**	34.9
Other income, net	**(0.6)**	(2.9)
Loss on extinguishment of debt		25.3
Income before income taxes	**40.8**	6.8
Income taxes	**1.0**	(1.3)
Net income	**$ 39.8**	$ 8.1
Net income per share basic and diluted	**$ 0.29**	$ 0.06

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions)

(Unaudited)

	March 31, 2011	December 31, 2010
Assets		
Current assets		
Cash and cash equivalents	**$ 242.3**	$ 119.1
Restricted cash	**5.8**	8.6
Trade receivables, net of allowances of $6.6 and $6.3	**405.0**	271.9
Finance receivables, net of allowances	**132.6**	126.2
Finance receivables securitized, net of allowances	**604.6**	635.7
Deferred income tax assets	**40.8**	40.8
Other current assets	**48.6**	52.4
Total current assets	**1,479.7**	1,254.7
Other assets		
Goodwill	**1,556.1**	1,554.1
Customer relationships, net of accumulated amortization of $273.7 and $254.3	**697.4**	712.6
Other intangible assets, net of accumulated amortization of $106.7 and $98.0	**273.0**	269.8
Unamortized debt issuance costs	**37.9**	41.4
Other assets	**11.3**	11.9
Total other assets	**2,575.7**	2,589.8
Property and equipment, net of accumulated depreciation of $318.1 and $299.8	**679.2**	680.5
Total assets	**$ 4,734.6**	$ 4,525.0

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions, except share and per share data)

(Unaudited)

	March 31, 2011	December 31, 2010
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	**$ 485.8**	$ 287.7
Accrued employee benefits and compensation expenses	**40.7**	57.2
Accrued interest	**23.1**	10.1
Other accrued expenses	**91.2**	88.8
Income taxes payable	**0.9**	2.9
Obligations collateralized by finance receivables	**492.1**	520.1
Total current liabilities	**1,133.8**	966.8
Non-current liabilities		
Long-term debt	**1,875.7**	1,875.7
Deferred income tax liabilities	**325.1**	326.3
Other liabilities	**97.1**	111.6
Total non-current liabilities	**2,297.9**	2,313.6
Commitments and contingencies (Note 9)		
Stockholders equity		
Preferred stock, $0.01 par value:		
Authorized shares: 100,000,000		
Issued shares: none		
Common stock, $0.01 par value:		
Authorized shares: 400,000,000		
Issued and outstanding shares:		
March 31, 2011: 135,697,894		
December 31, 2010: 135,493,537	**1.4**	1.4
Additional paid-in capital	**1,390.4**	1,381.6
Retained deficit	**(125.1)**	(164.9)
Accumulated other comprehensive income	**36.2**	26.5
Total stockholders equity	**1,302.9**	1,244.6
Total liabilities and stockholders equity	**$ 4,734.6**	$ 4,525.0

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 (Loss)	Total
Balance at December 31, 2010	135.5	$ 1.4	$ 1,381.6	($ 164.9)	$ 26.5	$ 1,244.6
Comprehensive income:						
Net income				39.8		39.8
Other comprehensive income, net of tax:						
Unrealized gain on interest rate derivatives					1.6	1.6
Foreign currency translation					8.1	8.1
Comprehensive income				39.8	9.7	49.5
Issuance of common stock under stock plans	0.2		1.1			1.1
Stock-based compensation expense			7.7			7.7
Balance at March 31, 2011	**135.7**	**$ 1.4**	**$ 1,390.4**	**($ 125.1)**	**$ 36.2**	**$ 1,302.9**

See accompanying Notes to Consolidated Financial Statements

KAR Auction Services, Inc.

Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Three Months Ended March 31, 2011	2010
Operating activities		
Net income	**$ 39.8**	$ 8.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**44.1**	43.3
Provision for credit losses	**3.2**	4.1
Deferred income taxes	**(2.9)**	(7.6)
Amortization of debt issuance costs	**3.4**	3.5
Stock-based compensation	**7.7**	6.8
Loss on disposal of fixed assets		0.3
Loss on extinguishment of debt		25.3
Other non-cash, net	**2.9**	3.6
Changes in operating assets and liabilities, net of acquisitions:		
Finance receivables held for sale		50.2
Retained interests in finance receivables sold		89.8
Trade receivables and other assets	**(130.4)**	(145.1)
Accounts payable and accrued expenses	**113.5**	149.9
Net cash provided by operating activities	**81.3**	232.2
Investing activities		
Net decrease (increase) in finance receivables held for investment	**24.6**	(539.2)
Acquisition of businesses and related contingent payments, net of cash acquired	**(6.3)**	(2.7)
Purchases of property, equipment and computer software	**(16.1)**	(8.6)
Proceeds from the sale of property and equipment		1.7
Decrease (increase) in restricted cash	**2.8**	(0.8)
Net cash provided by (used by) investing activities	**5.0**	(549.6)
Financing activities		
Net increase in book overdrafts	**64.1**	20.0
Net (decrease) increase in obligations collateralized by finance receivables	**(28.0)**	433.9
Payments on long-term debt		(28.3)
Payment for early extinguishment of debt		(243.6)
Payments on capital leases	**(1.1)**	(1.1)
Issuance of common stock under stock plans	**1.1**	0.2
Net cash provided by financing activities	**36.1**	181.1
Effect of exchange rate changes on cash	**0.8**	0.4
Net increase (decrease) in cash and cash equivalents	**123.2**	(135.9)
Cash and cash equivalents at beginning of period	**119.1**	363.9
Cash and cash equivalents at end of period	**$ 242.3**	$ 228.0

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements

March 31, 2011 (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 related subsidiaries;

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

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, November 11, 2010 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. 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

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

for the year ended December 31, 2010 included in our Annual Report on Form 10-K for the year ended December 31, 2010. The 2010 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.

Business and Nature of Operations

As of March 31, 2011, we have a network of 70 ADESA whole car auctions and 159 IAAI salvage vehicle auctions which facilitate 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 remarketing services for the automotive industry in North America. 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 IAAI 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 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 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 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 was provided through 88 loan production offices located throughout North America at March 31, 2011. 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 Acquisition

During the first quarter of 2011, we completed the acquisition of a company that develops satellite-based, GPS technology for advanced vehicle tracking. The purchase agreement included contingent payments related to business deployments subsequent to the purchase date. The purchased assets included fixed assets, software, accounts receivable and other intangible assets. Financial results for the acquisition have been included in our consolidated financial statements from the date of acquisition. The financial impact of this acquisition, including pro forma financial results, was immaterial to our balance sheet and statement of income.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (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. On February 25, 2011, we granted approximately 0.2 million service options with an exercise price of $14.44 per share under the Omnibus Plan. The service options have a ten year life and vest in four equal annual installments, commencing on the first anniversary of the grant date.

Our stock-based compensation expense includes expense associated with KAR Auction Services, Inc. service and exit option awards, KAR LLC operating unit awards and Axle LLC operating unit awards. We have classified the KAR LLC and Axle 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 $7.7 million and $6.8 million for the three months ended March 31, 2011 and 2010, and the total income tax benefit recognized in the consolidated statements of income for options was approximately $1.6 million for the three months ended March 31, 2011 and 2010. There is no income tax benefit associated with the KAR LLC and Axle LLC operating unit awards. We recognized compensation expense for the service and exit options of approximately $4.4 million and $4.5 million for the three months ended March 31, 2011 and 2010. We recognized compensation expense for the KAR LLC and Axle LLC operating unit awards of approximately $3.3 million and $2.3 million for the three months ended March 31, 2011 and 2010. We did not capitalize any stock-based compensation cost in the three months ended March 31, 2011 or 2010.

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 March 31,	
	2011	**2010**
Net income	**$ 39.8**	$ 8.1
Weighted average common shares outstanding	**135.6**	134.5
Effect of dilutive stock options	**1.5**	1.5
Weighted average common shares outstanding and potential common shares	**137.1**	136.0
Net income per share basic and diluted	**$ 0.29**	$ 0.06

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.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Approximately 0.6 million options were excluded from the calculation of diluted net income per share for the three months ended March 31, 2011 and 2010. Total options outstanding at March 31, 2011 and 2010 were 9.2 million and 10.1 million.

Note 5 Finance Receivables and Obligations Collateralized by Finance Receivables

AFC sells the majority of its U.S. dollar denominated finance receivables on a revolving basis and without recourse to a wholly owned, bankruptcy remote, consolidated, special purpose subsidiary (AFC Funding Corporation), established for the purpose of purchasing AFC s finance receivables. A securitization agreement allows for the revolving sale by AFC Funding Corporation to a bank conduit facility of undivided interests in certain eligible finance receivables subject to committed liquidity. The agreement was set to expire on April 20, 2012. AFC Funding Corporation had committed liquidity of $450 million from a third party conduit for U.S. finance receivables at March 31, 2011.

On April 26, 2011, AFC and AFC Funding Corporation entered into the Fourth Amended and Restated Receivables Purchase Agreement (the Receivables Purchase Agreement). The Receivables Purchase Agreement increases AFC Funding s U.S. committed liquidity to $650 million and extends the facility s maturity date to June 30, 2014. In addition, the interest costs for amounts borrowed increased approximately 0.5% and 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.

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 through another third party conduit. The agreement expires on April 20, 2012.

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.

	March 31, 2011 Principal Amount of:		**Net Credit Losses Three Months Ended**	**Net Credit Losses Three Months Ended**	**December 31, 2010 Principal Amount of:**	
(in millions)	**Receivables**	**Receivables Delinquent**	**March 31, 2011**	**March 31, 2010**	**Receivables**	**Receivables Delinquent**
Floorplan receivables	**$ 740.4**	**$ 2.9**	**$ 2.7**	$ 2.7	$ 765.0	$ 4.8
Special purpose loans	**6.4**	**0.8**			6.6	0.8
Total receivables managed	**$ 746.8**	**$ 3.7**	**$ 2.7**	$ 2.7	$ 771.6	$ 5.6

AFC s allowance for losses of $9.6 million and $9.7 million at March 31, 2011 and December 31, 2010, respectively, includes an estimate of losses for finance receivables, as well as an allowance for any further deterioration in the finance receivables after they are repurchased from the bank conduit facility.

As of March 31, 2011 and December 31, 2010, $741.8 million and $763.9 million of finance receivables and a cash reserve of 1 percent of finance receivables securitized served as security for the $492.1 million and $520.1 million of obligations collateralized by finance receivables at March 31, 2011 and December 31, 2010. The amount of the cash reserve depends on circumstances which are set forth in the securitization agreements.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Proceeds from the revolving sale of receivables to the bank conduit facility are used to fund new loans to customers. AFC, AFC Funding Corporation and AFCI must maintain certain financial covenants including, among others, limits on the amount of debt AFC and AFCI can incur, minimum levels of tangible net worth, and other covenants tied to the performance of the finance receivables portfolio. The securitization agreements also incorporate the financial covenants of our credit facility. At March 31, 2011, we were in compliance with the covenants in the securitization agreements.

Note 6 Long-Term Debt

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

	Interest Rate	Maturity	March 31, 2011	December 31, 2010
Term Loan B	LIBOR + 2.75%	October 19, 2013	**$ 1,144.6**	$ 1,144.6
$250 million revolving credit facility	LIBOR + 2.75%	April 19, 2013		
Floating rate senior notes	LIBOR + 4.00%	May 01, 2014	**150.0**	150.0
Senior notes	8.75%	May 01, 2014	**450.0**	450.0
Senior subordinated notes	10%	May 01, 2015	**131.1**	131.1
Canadian line of credit	CAD Prime + 1.5%			
Total debt			**1,875.7**	1,875.7
Less current portion of long-term debt				
Long-term debt			**$ 1,875.7**	$ 1,875.7

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. As part of an amendment to the Credit Agreement in 2009, among other items, available borrowings under the revolving credit facility were reduced to $250 million. There were no borrowings under the revolver at March 31, 2011 and December 31, 2010, although we did have related outstanding letters of credit in the aggregate amount of $29.6 million and $29.4 million at March 31, 2011 and December 31, 2010, respectively, which reduce the amount available for borrowings under our credit facility.

The senior secured credit facilities are guaranteed by KAR Auction Services and each of our direct and indirect present and future 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

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

subject to a senior secured leverage ratio test, provided there are revolving loans outstanding. There were no revolving loans outstanding at March 31, 2011. We were in compliance with the covenants in the credit facility at March 31, 2011.

Senior Notes

In 2007, we issued $450.0 million of 8 3/4% 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 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. 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 March 31, 2011, the estimated fair value of our long-term debt amounted to $1,882.7 million. The estimates of fair value are based on the market prices for our publicly-traded debt as of March 31, 2011. The estimates presented on long-term financial instruments are not necessarily indicative of the amounts that would be realized in a current market exchange.

Note 7 Derivatives

We are exposed to interest rate risk on our variable rate borrowings. Accordingly, interest rate fluctuations affect the amount of interest expense we are obligated to pay. In 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.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

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. The following table presents the fair value of our interest rate derivatives included in the consolidated balance sheet for the periods presented (*in millions*):

	Asset Derivatives				Liability Derivatives			
	March 31, 2011		December 31, 2010		March 31, 2011		December 31, 2010	
Derivatives Designated as Hedging 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	**$ 14.1**	Other accrued expenses	$ 16.6
$250 million notional interest rate cap	Other current assets	**$**	Other current assets	$	Other accrued expenses	**$**	Other accrued expenses	$

The earnings impact of the interest rate derivatives designated as cash flow hedges is recorded upon the recognition of the interest related to the hedged debt. Any ineffectiveness in the hedging relationships is recognized in current earnings. There was no significant ineffectiveness in the first three months of 2011 or 2010. Unrealized gains or losses on the interest rate derivatives are included as a component of Accumulated other comprehensive income. At March 31, 2011, there was a net unrealized loss totaling $8.9 million, net of tax benefits of $5.4 million. At December 31, 2010, there was a net unrealized loss totaling $10.5 million, net of tax benefits of $6.4 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	**Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion) Three Months Ended March 31,**		**Location of Gain / (Loss) Reclassified from Accumulated OCI into Income**	**Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) Three Months Ended March 31,**	
Cash Flow Hedging Relationships	**2011**	**2010**	**(Effective Portion)**	**2011**	**2010**
$650 million notional interest rate swap	**$2.5**	($ 5.3)	Interest expense	**($ 3.1)**	($ 3.2)
$250 million notional interest rate cap	**$0.2**	($ 0.3)	N/A	**$**	$

Note 8 Income Taxes

During the first quarter of 2011, our effective tax rate of 2.5% benefited from the reversal of $14.4 million in tax reserves for uncertain tax positions due to the expiration of certain statute of limitations. Excluding the effect of the release of the tax reserves, our effective tax rate for the three months ended March 31, 2011 would have been 37.9%.

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows (*in millions*):

	March 31, 2011	December 31, 2010
Balance at beginning of period	**$ 25.9**	$ 26.4
Increase in tax positions related to acquisitions		
Increase in prior year tax positions	**0.1**	1.4
Decrease in prior year tax positions		(0.7)
Increase in current year tax positions	**0.1**	1.3
Settlements	**(0.5)**	(0.2)
Lapse in statute of limitations	**(14.4)**	(2.3)
Balance at end of period	**$ 11.2**	$ 25.9

Note 9 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, 2010. Also reference Part II, Item I (Legal Proceedings) of this report.

Note 10 Comprehensive Income

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

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
Net income	**$ 39.8**	$ 8.1
Other comprehensive income, net of tax		
Foreign currency translation gain	**8.1**	6.4
Unrealized gain (loss) on interest rate derivatives	**1.6**	(3.4)
Comprehensive income	**$ 49.5**	$ 11.1

The composition of Accumulated other comprehensive income at March 31, 2011, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $8.9 million, a $0.2 million

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $44.9 million. The composition of Accumulated other comprehensive income at December 31, 2010, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $10.5 million, a $0.2 million unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $36.8 million.

Note 11 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	**March 31, 2011**	**Quoted Prices in Active Markets for Identical Assets (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**
Assets:				
Interest rate cap	$	$	$	$
Liabilities:				
Interest rate swap	$ 14.1	$	$ 14.1	$

Description	**December 31, 2010**	**Quoted Prices in Active Markets for Identical**	**Significant Other Observable Inputs**	**Significant Unobservable Inputs (Level 3)**

			Assets (Level 1)		(Level 2)			
Assets:								
Interest rate cap	$		$		$		$	
Liabilities:								
Interest rate swap	$	16.6	$		$	16.6	$	

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

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 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. 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.

Financial information regarding our reportable segments is set forth below for the three months ended March 31, 2011 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 268.3	$ 175.9	$ 38.5	$	$ 482.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	155.0	100.4	7.7		263.1
Selling, general and administrative	55.1	20.6	4.5	21.9	102.1
Depreciation and amortization	21.4	16.4	6.2	0.1	44.1
Total operating expenses	231.5	137.4	18.4	22.0	409.3
Operating profit (loss)	36.8	38.5	20.1	(22.0)	73.4
Interest expense	0.2	0.6	2.1	30.3	33.2
Other (income) expense, net	(0.3)	(0.3)			(0.6)
Intercompany expense (income)	13.2	9.6	(3.2)	(19.6)	
Income (loss) before income taxes	23.7	28.6	21.2	(32.7)	40.8
Income taxes	(2.1)	9.4	6.2	(12.5)	1.0
Net income (loss)	$ 25.8	$ 19.2	$ 15.0	($ 20.2)	$ 39.8
Assets	$ 2,428.9	$ 1,243.9	$ 1,194.0	($ 132.2)	$ 4,734.6

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Financial information regarding our reportable segments is set forth below for the three months ended March 31, 2010 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 273.6	$ 158.8	$ 26.0	$	$ 458.4
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	156.0	93.5	6.5		256.0
Selling, general and administrative	51.8	20.6	3.8	18.8	95.0
Depreciation and amortization	22.1	14.8	6.2	0.2	43.3
Total operating expenses	229.9	128.9	16.5	19.0	394.3
Operating profit (loss)	43.7	29.9	9.5	(19.0)	64.1
Interest expense	0.2	0.5	1.4	32.8	34.9
Other (income) expense, net		(0.4)		(2.5)	(2.9)
Loss on extinguishment of debt				25.3	25.3
Intercompany expense (income)	10.9	9.5	(2.2)	(18.2)	
Income (loss) before income taxes	32.6	20.3	10.3	(56.4)	6.8
Income taxes	9.8	8.5	4.5	(24.1)	(1.3)
Net income (loss)	$ 22.8	$ 11.8	$ 5.8	($ 32.3)	$ 8.1
Assets	$ 2,340.4	$ 1,193.4	$ 1,091.7	$ 4.0	$ 4,629.5

Note 13 Supplemental Guarantor Information

Our obligations related to Term Loan B, the revolving credit facility, 10% senior subordinated notes, 8 3/4% senior notes and floating rate senior notes are guaranteed on a full, unconditional, joint and several basis by certain direct and indirect present and future domestic subsidiaries (the Guarantor Subsidiaries). AFC Funding Corporation and all of our foreign subsidiaries are not guarantors (the Non-Guarantor Subsidiaries). The following financial information sets forth, on a condensed consolidating basis, the balance sheets, statements of income and statements of cash flows for the periods indicated for KAR Auction Services, the Guarantor Subsidiaries, the Non-Guarantor Subsidiaries and the eliminations to arrive at KAR Auction Services on a consolidated basis.

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

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Statement of Income

For the Three Months Ended March 31, 2011

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 373.3	$ 109.4	$	$ 482.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		223.6	39.5		263.1
Selling, general and administrative	4.2	83.8	14.1		102.1
Depreciation and amortization		38.0	6.1		44.1
Total operating expenses	4.2	345.4	59.7		409.3
Operating profit (loss)	(4.2)	27.9	49.7		73.4
Interest expense	15.4	15.3	2.5		33.2
Other income, net		(0.2)	(0.4)		(0.6)
Intercompany expense (income)		(4.0)	4.0		
Income (loss) before income taxes	(19.6)	16.8	43.6		40.8
Income taxes	(7.4)	(7.1)	15.5		1.0
Net income (loss)	($ 12.2)	$ 23.9	$ 28.1	$	$ 39.8

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Statement of Income

For the Three Months Ended March 31, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 356.8	$ 101.6	$	$ 458.4
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		215.5	40.5		256.0
Selling, general and administrative	3.2	79.5	12.3		95.0
Depreciation and amortization		37.4	5.9		43.3
Total operating expenses	3.2	332.4	58.7		394.3
Operating profit (loss)	(3.2)	24.4	42.9		64.1
Interest expense	17.6	13.8	3.5		34.9
Other (income) expense, net		(2.7)	(0.2)		(2.9)
Loss on extinguishment of debt	25.3				25.3
Intercompany expense (income)		(4.1)	4.1		
Income (loss) before income taxes	(46.1)	17.4	35.5		6.8
Income taxes	(15.2)	1.1	12.8		(1.3)
Net income (loss)	($ 30.9)	$ 16.3	$ 22.7	$	$ 8.1

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Balance Sheet

As of March 31, 2011

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
Current assets					
Cash and cash equivalents	$	$ 215.0	$ 27.3	$	$ 242.3
Restricted cash			5.8		5.8
Trade receivables, net of allowances		326.9	95.2	(17.1)	405.0
Finance receivables, net of allowances		4.9	127.7		132.6
Finance receivables securitized, net of allowances			604.6		604.6
Deferred income tax assets	1.5	39.3			40.8
Other current assets	0.8	41.6	6.2		48.6
Total current assets	2.3	627.7	866.8	(17.1)	1,479.7
Other assets					
Investments in and advances to affiliates, net	2,524.1	266.5	94.6	(2,885.2)	
Goodwill		1,551.9	4.2		1,556.1
Customer relationships, net of accumulated amortization		589.5	107.9		697.4
Other intangible assets, net of accumulated amortization		265.5	7.5		273.0
Unamortized debt issuance costs	37.9				37.9
Other assets		10.2	1.1		11.3
Total other assets	2,562.0	2,683.6	215.3	(2,885.2)	2,575.7
Property and equipment, net of accumulated depreciation		536.3	142.9		679.2
Total assets	$ 2,564.3	$ 3,847.6	$ 1,225.0	($ 2,902.3)	$ 4,734.6

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Balance Sheet

As of March 31, 2011

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders Equity					
Current liabilities					
Accounts payable	$	$ 444.5	$ 58.4	($ 17.1)	$ 485.8
Accrued employee benefits and compensation expenses		37.1	3.6		40.7
Accrued interest	23.0		0.1		23.1
Other accrued expenses	10.6	71.0	9.6		91.2
Income taxes payable		2.2	(1.3)		0.9
Obligations collateralized by finance receivables			492.1		492.1
Total current liabilities	33.6	554.8	562.5	(17.1)	1,133.8
Non-current liabilities					
Investments by and advances from affiliates, net	113.3			(113.3)	
Long-term debt	1,054.2	821.5			1,875.7
Deferred income tax liabilities	(4.0)	302.8	26.3		325.1
Other liabilities	14.1	76.1	6.9		97.1
Total non-current liabilities	1,177.6	1,200.4	33.2	(113.3)	2,297.9
Commitments and contingencies					
Stockholders equity					
Total stockholders equity	1,353.1	2,092.4	629.3	(2,771.9)	1,302.9
Total liabilities and stockholders equity	$ 2,564.3	$ 3,847.6	$ 1,225.0	($ 2,902.3)	$ 4,734.6

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Balance Sheet

As of December 31, 2010

(In millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
Current assets					
Cash and cash equivalents	$	$ 99.3	$ 19.8	$	$ 119.1
Restricted cash			8.6		8.6
Trade receivables, net of allowances		233.6	51.6	(13.3)	271.9
Finance receivables, net of allowances		7.6	118.6		126.2
Finance receivables securitized, net of allowances			635.7		635.7
Deferred income tax assets	1.5	39.3			40.8
Other current assets	1.2	47.5	3.7		52.4
Total current assets	2.7	427.3	838.0	(13.3)	1,254.7
Other assets					
Investments in and advances to affiliates, net	2,472.6	292.2	82.3	(2,847.1)	
Goodwill		1,550.1	4.0		1,554.1
Customer relationships, net of accumulated amortization		605.2	107.4		712.6
Other intangible assets, net of accumulated amortization		261.6	8.2		269.8
Unamortized debt issuance costs	41.4				41.4
Other assets		10.9	1.0		11.9
Total other assets	2,514.0	2,720.0	202.9	(2,847.1)	2,589.8
Property and equipment, net of accumulated depreciation		539.1	141.4		680.5
Total assets	$ 2,516.7	$ 3,686.4	$ 1,182.3	($ 2,860.4)	$ 4,525.0

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Balance Sheet

As of December 31, 2010

(In millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders Equity					
Current liabilities					
Accounts payable	$	$ 283.3	$ 17.7	($ 13.3)	$ 287.7
Accrued employee benefits and compensation expenses		52.5	4.7		57.2
Accrued interest	9.9		0.2		10.1
Other accrued expenses	3.2	76.4	9.2		88.8
Income taxes payable		0.9	2.0		2.9
Obligations collateralized by finance receivables			520.1		520.1
Total current liabilities	13.1	413.1	553.9	(13.3)	966.8
Non-current liabilities					
Investments by and advances from affiliates, net	75.2			(75.2)	
Long-term debt	1,054.2	821.5			1,875.7
Deferred income tax liabilities	(4.9)	304.2	27.0		326.3
Other liabilities	16.6	88.4	6.6		111.6
Total non-current liabilities	1,141.1	1,214.1	33.6	(75.2)	2,313.6
Commitments and contingencies					
Stockholders equity					
Total stockholders equity	1,362.5	2,059.2	594.8	(2,771.9)	1,244.6
Total liabilities and stockholders equity	$ 2,516.7	$ 3,686.4	$ 1,182.3	($ 2,860.4)	$ 4,525.0

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Statement of Cash Flows

For the Three Months Ended March 31, 2011

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash (used by) provided by operating activities	$ (1.1)	$ 71.5	$ 10.9	$	$ 81.3
Investing activities					
Net decrease (increase) in finance receivables held for investment		2.8	21.8		24.6
Acquisition of businesses and related contingent payments, net of cash acquired		(6.3)			(6.3)
Purchases of property, equipment and computer software		(15.9)	(0.2)		(16.1)
(Increase) decrease in restricted cash			2.8		2.8
Net cash (used by) provided by investing activities		(19.4)	24.4		5.0
Financing activities					
Net increase (decrease) in book overdrafts		64.5	(0.4)		64.1
Net decrease in obligations collateralized by finance receivables			(28.0)		(28.0)
Payments on capital leases		(0.9)	(0.2)		(1.1)
Issuance of common stock under stock plans	1.1				1.1
Net cash provided by (used by) financing activities	1.1	63.6	(28.6)		36.1
Effect of exchange rate changes on cash			0.8		0.8
Net increase (decrease) in cash and cash equivalents		115.7	7.5		123.2
Cash and cash equivalents at beginning of period		99.3	19.8		119.1
Cash and cash equivalents at end of period	$	$ 215.0	$ 27.3	$	$ 242.3

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

March 31, 2011 (Unaudited)

Condensed Consolidating Statement of Cash Flows

For the Three Months Ended March 31, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash (used by) provided by operating activities	$ 271.7	($ 158.1)	$ 118.6	$	$ 232.2
Investing activities					
Net decrease (increase) in finance receivables held for investment		3.5	(542.7)		(539.2)
Acquisition of businesses, net of cash acquired		(2.7)			(2.7)
Purchases of property, equipment and computer software		(8.3)	(0.3)		(8.6)
Proceeds from sale of property, equipment and computer software		1.7			1.7
(Increase) decrease in restricted cash		0.1	(0.9)		(0.8)
Net cash (used by) provided by investing activities		(5.7)	(543.9)		(549.6)
Financing activities					
Net increase (decrease) in book overdrafts		19.9	0.1		20.0
Net increase in obligations collateralized by finance receivables			433.9		433.9
Payments on long-term debt	(28.3)				(28.3)
Payment for early extinguishment of debt	(243.6)				(243.6)
Payments on capital leases		(1.0)	(0.1)		(1.1)
Issuance of common stock under stock plans	0.2				0.2
Net cash provided by (used by) financing activities	(271.7)	18.9	433.9		181.1
Effect of exchange rate changes on cash			0.4		0.4
Net increase (decrease) in cash and cash equivalents		(144.9)	9.0		(135.9)
Cash and cash equivalents at beginning of period		339.8	24.1		363.9
Cash and cash equivalents at end of period	$	$ 194.9	$ 33.1	$	$ 228.0

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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, potential refinancings 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 forw statements. Such statements, including statements regarding our future growth; anticipated cost savings, revenue increases and capital expenditures; strategic initiatives, greenfields and acquisitions; our competitive position; and our continued investment in information technology are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from the results projected, expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010 filed on February 24, 2011. Some of these factors include:

- fluctuations in consumer demand for and in the supply of used, leased and salvage vehicles and the resulting impact on auction sales volumes, conversion rates and loan transaction volumes;
- trends in new and used vehicle sales and incentives, including wholesale used vehicle pricing;
- the ability of consumers to lease or finance the purchase of new and/or used vehicles;
- the ability to recover or collect from delinquent or bankrupt customers;
- economic conditions including fuel prices, foreign exchange rates and interest rate fluctuations;
- trends in the vehicle remarketing industry;
- changes in the volume of vehicle production, including capacity reductions at the major original equipment manufacturers;
- 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 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;

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

Overview

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

- The ADESA Auctions segment consisted primarily of a 70 whole car auction network in North America at March 31, 2011. Vehicles at ADESA s auctions are typically sold by commercial fleet operators, financial institutions, rental car companies, used vehicle dealers and vehicle manufacturers and their captive finance companies to franchised and independent used vehicle dealers. ADESA also provides value-added ancillary services including inspections, storage, transportation, reconditioning and titling and other administrative services.

The IAAI segment consisted of salvage vehicle auctions and related services provided at 159 sites in North America at March 31, 2011. The salvage auctions facilitate the remarketing of damaged or low value vehicles designated as total losses by insurance companies and charity donation vehicles, as well as recovered stolen (or theft) vehicles. The salvage auction business specializes in providing services such as transportation, titling, salvage recovery and claims settlement administrative services.

The AFC segment provides short-term, inventory-secured financing, known as floorplan financing, primarily to independent used vehicle dealers. At March 31, 2011, AFC conducted business through 88 branches in North America.

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

Industry Trends

Whole Car

During the period from 1999 to 2009, despite fluctuations in economic conditions, new vehicle sales and churn (i.e., the rate of ownership transfer of vehicles in the used vehicle market), used vehicles sold in North America through whole car auctions remained within the relatively narrow range of approximately 9 million to 10 million used vehicles per year. We estimate that the vehicle population in the United States has increased from 209.5 million units in 1999 to in excess of 248 million units in 2010 and therefore the used vehicle market, and hence the used vehicle auction industry, have an even larger inventory of potential transactions to draw from. A larger vehicle population may partially offset any short-term decreases in new vehicle sales, which we believe has resulted in vehicle auction volumes remaining fairly consistent over the last several years. However, according to the National Auto Auction Association, whole car auction volume was approximately 8.4 million units for the year ended December 31, 2010. We believe that, despite challenging conditions in the overall economy and the automotive industry and the attendant fluctuations in new vehicle sales and churn, used vehicle auction volumes in North America in the foreseeable future will be within the range of approximately 8 million to 9 million used vehicles per year. The decline in industry auction volumes in 2010 as compared to the period from 1999 to 2009 reflects a reduction in units sold by institutional consignors. This decrease was partially offset by an increase in dealer consignment units sold in 2010 as compared to 2009.

Salvage

During the period from 2006 through 2009, the North American salvage vehicle auction industry volumes increased. Vehicles deemed a total loss by automobile insurance companies represent the largest category of vehicles sold in the salvage vehicle auction industry. As vehicles become more complex with additional enhancements, such as airbags and electrical components, they are more costly to repair following an accident and insurance companies are more likely to declare a damaged vehicle a total loss. The percentage of claims resulting in total losses steadily increased to over 14% in 2009 and was slightly below 14% in 2010. For the year ended December 31, 2010 as compared with the year ended December 31, 2009, we believe the salvage industry auction volumes were down slightly. To the extent this trend continues, it could have an adverse impact on IAAI s results of operations.

Automotive Finance

In 2008 and 2009, the overall economy and in particular the automotive finance industries faced pressures, which negatively affected the used vehicle dealer base. More than 6,300 independent dealers went out of business during 2008 and 2009, representing almost a 15% reduction in the independent dealer base. Used vehicle dealers experienced a significant decline in sales which resulted in a decrease in consumer auto loan originations and an increased number of dealers defaulting on their loans, which increased credit losses. In addition, the value of recovered collateral on defaulted loans was impacted to some degree by the volatility in the vehicle pricing market. To the extent these negative trends recur, they could have a material adverse impact on AFC s results of operations.

Despite the negative factors and trends impacting the automotive finance industry in 2008 and 2009, AFC s financial results improved in the second half of 2009 and throughout 2010. AFC implemented a number of strategic initiatives in 2008 and early 2009 designed to tighten credit standards and reduce risk and exposure in

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its portfolio of finance receivables. These initiatives have resulted in a substantial ongoing improvement in the aging of the managed portfolio, which was over 99 percent current at March 31, 2011. In addition, AFC s managed portfolio of finance receivables grew approximately 15 percent from March 31, 2010 to $746.8 million at March 31, 2011.

General

In 2008 and 2009, significant changes occurred in the economy which impacted our business. A lack of availability of consumer credit for retail used vehicle buyers, a decline in consumer spending, a reduction in the number of franchised and independent used vehicle dealers in the United States, reduced miles driven and decreases in commodity prices such as steel and platinum all negatively impacted us. Additionally, factors that influenced our business in 2010 included increases in used vehicle prices, supply constraints resulting from the decline in new vehicle sales during the recession, a decrease in the number of repossessions, lower loan default rates and fewer vehicles being classified as total loss vehicles by the insurance industry.

The availability of financing to franchised dealerships and consumers from the vehicle manufacturers captive finance companies and their respective remarketing programs may also impact the supply of vehicles to the wholesale auction industry in the future. A change in the supply of used vehicles could impact the value of used vehicles sold, conversion rates (calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale) and ADESA s profitability on the sale of vehicles. In addition, we believe the reduced number of lease originations in 2008 and 2009 will negatively impact the supply of off-lease vehicles available at auction in 2011 and 2012.

Seasonality

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

Sources of Revenues and Expenses

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

Accounting Standards Update 2009-16 amended ASC 860, *Transfers and Servicing*, and we adopted the guidance on January 1, 2010. The guidance eliminated securitization income accounting and resulted in the recording of interest and fee income, provision for credit losses and interest expense for the finance receivable transactions under the revolving sale agreement. The elimination of the gain on sale treatment resulted in a reduction of revenue of $2.8 million in the first quarter of 2010.

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

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Results of Operations

Overview of Results of KAR Auction Services for the Three Months Ended March 31, 2011 and 2010:

(Dollars in millions except per share amounts)	**Three Months Ended March 31, 2011**	**2010**
Revenues		
ADESA	**$ 268.3**	$ 273.6
IAAI	**175.9**	158.8
AFC	**38.5**	26.0
Total revenues	**482.7**	458.4
Cost of services*	**263.1**	256.0
Gross profit*	**219.6**	202.4
Selling, general and administrative	**102.1**	95.0
Depreciation and amortization	**44.1**	43.3
Operating profit	**73.4**	64.1
Interest expense	**33.2**	34.9
Other income, net	**(0.6)**	(2.9)
Loss on extinguishment of debt		25.3
Income before income taxes	**40.8**	6.8
Income taxes	**1.0**	(1.3)
Net income	**$ 39.8**	$ 8.1
Net income per share basic and diluted	**$ 0.29**	$ 0.06

* Exclusive of depreciation and amortization

For the three months ended March 31, 2011, we had revenue of $482.7 million compared with revenue of $458.4 million for the three months ended March 31, 2010, an increase of 5%. 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 $0.8 million, or 2%, to $44.1 million for the three months ended March 31, 2011, compared with $43.3 million for the three months ended March 31, 2010. The increase is representative of increased amortization resulting from certain assets placed in service during 2010 and the first quarter of 2011, partially offset by a decrease in depreciation expense due to certain assets becoming fully depreciated.

Interest Expense

Interest expense decreased $1.7 million, or 5%, to $33.2 million for the three months ended March 31, 2011, compared with interest expense of $34.9 million for the three months ended March 31, 2010. The decrease in interest expense was primarily the result of $143.3 million in prepayments on long-term debt in the fourth quarter of 2010. Partially offsetting the decrease was an increase in interest expense of $0.7 million at AFC related to the increase in securitized finance receivables for three months ended March 31, 2011 compared with the three months ended March 31, 2010.

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Other Income

Other income was $0.6 million for the three months ended March 31, 2011, compared with $2.9 million for the three months ended March 31, 2010. The change in other income was primarily representative of a decrease in foreign currency transaction gains.

Loss on Extinguishment of Debt

In connection with our initial public offering, we conducted a cash tender offer for certain of our notes. The tender offer was oversubscribed and as such, in accordance with the identified priority levels, only a portion of the 10% senior subordinated notes tendered 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. In the first quarter of 2010, we recorded a $25.3 million pretax charge representative of the net premiums payable related to the repurchase of the 10% senior subordinated notes, the write-off of certain unamortized debt issuance costs associated with our 10% senior subordinated notes and certain expenses related to the tender offer.

Income Taxes

Our effective tax rate was 2.5% for the three months ended March 31, 2011, compared with a benefit of 19.1% for the three months ended March 31, 2010. During the first quarter of 2011, our effective tax rate of 2.5% benefited from the reversal of $14.4 million in tax reserves for uncertain tax positions due to the expiration of certain statute of limitations. Excluding the effect of discrete items, our effective tax rates for the three months ended March 31, 2011 and March 31, 2010 would have been 37.9% and 42.4%, respectively. The change in the tax rate, excluding the effect of discrete items, was primarily attributable to the reduction of expenses permanently nondeductible for tax purposes, the increase in consolidated pre-tax profits and lower tax rates in certain state jurisdictions.

ADESA Results

	Three Months Ended March 31,	
(Dollars in millions)	**2011**	**2010**
ADESA revenue	**$ 268.3**	$ 273.6
Cost of services*	**155.0**	156.0
Gross profit*	**113.3**	117.6
Selling, general and administrative	**55.1**	51.8
Depreciation and amortization	**21.4**	22.1
Operating profit	**$ 36.8**	$ 43.7

* Exclusive of depreciation and amortization

Revenue

Revenue from ADESA decreased $5.3 million, or 2%, to $268.3 million for the three months ended March 31, 2011, compared with $273.6 million for the three months ended March 31, 2010. The decrease in revenue was primarily a result of a 6% decrease in the number of vehicles sold, partially offset by a 4% increase in revenue per vehicle sold to over $580 for the three months ended March 31, 2011, compared to approximately $560 for the three months ended March 31, 2010.

The 4% increase in revenue per vehicle sold was attributable to incremental fee income related to higher used vehicle values, increased auction fee revenue per vehicle resulting from the 18% increase in dealer consignment units sold and selective fee increases, which resulted in increased ADESA revenue of

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approximately $4.8 million. In addition, fluctuations in the Canadian exchange rate resulted in increased ADESA revenue of approximately $2.9 million, and increases in ancillary services resulted in increased ADESA revenue of approximately $0.5 million.

The total number of used vehicles sold at ADESA decreased 6% for the three months ended March 31, 2011, compared with the three months ended March 31, 2010, and resulted in a decrease in ADESA revenue of approximately $13.5 million. The decrease in volume sold was attributable to a decline in supplier inventory levels in the first three months of 2011 compared to the first three months of 2010. Online sales volumes for ADESA in the first three months of 2011 represented approximately 24% of the total vehicles sold by ADESA.

The used vehicle conversion percentage, calculated as the number of vehicles sold as a percentage of the number of vehicles entered for sale at our used vehicle auctions, decreased to 66.7% for the three months ended March 31, 2011, compared with 68.7% for the three months ended March 31, 2010. The decrease in conversion rates is representative of a change in the mix of vehicles sold toward more dealer consignment vehicles, which convert at a lower rate. For the three months ended March 31, 2011, dealer consignment vehicles represented more than 38% of used vehicles sold at ADESA, an increase from approximately 31% for the three months ended March 31, 2010.

Gross Profit

For the three months ended March 31, 2011, gross profit for ADESA decreased $4.3 million, or 4%, to $113.3 million, compared to $117.6 million for the three months ended March 31, 2010. Gross profit for ADESA was 42.2% of revenue for the three months ended March 31, 2011, compared with 43.0% of revenue for the three months ended March 31, 2010. The decrease in gross profit as a percentage of revenue for the three months ended March 31, 2011, compared with the three months ended March 31, 2010 was primarily the result of the 6% decrease in the number of vehicles sold and the related decrease in revenue.

Selling, General and Administrative

Selling, general and administrative expenses for the ADESA segment increased $3.3 million, or 6%, to $55.1 million for the three months ended March 31, 2011, compared with $51.8 million for the three months ended March 31, 2010, primarily due to increases for costs at acquired sites, fluctuations in the Canadian exchange rate and travel costs.

IAAI Results

	Three Months Ended March 31,	
(Dollars in millions)	**2011**	**2010**
IAAI revenue	**$ 175.9**	$ 158.8
Cost of services*	**100.4**	93.5
Gross profit*	**75.5**	65.3
Selling, general and administrative	**20.6**	20.6
Depreciation and amortization	**16.4**	14.8
Operating profit	**$ 38.5**	$ 29.9

* Exclusive of depreciation and amortization

Revenue

Revenue from IAAI increased $17.1 million, or 11%, to $175.9 million for the three months ended March 31, 2011, compared with $158.8 million for the three months ended March 31, 2010. The increase in

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revenue was primarily a result of an increase in fee revenue due to an increase in average selling price for vehicles sold at auction and the incremental revenue attributable to non-insurance vehicles sold in the three months ended March 31, 2011. For the three months ended March 31, 2011, total salvage vehicles sold increased approximately 4%. Online sales volumes for IAAI for the first three months of 2011 represented approximately half of the total vehicles sold by IAAI.

Gross Profit

For the three months ended March 31, 2011, gross profit at IAAI increased to $75.5 million, or 42.9% of revenue, compared with $65.3 million, or 41.1% of revenue, for the three months ended March 31, 2010. The gross profit increase was primarily the result of the increase in revenue. Cost of services increased primarily as a result of expenses associated with costs at acquired sites, increases in yard and auction expenses and an increase in purchased vehicles, which represent less than 5% of total salvage vehicles sold.

Selling, General and Administrative

Selling, general and administrative expenses at IAAI were $20.6 million for each of the three months ended March 31, 2011 and 2010.

AFC Results

	Three Months Ended March 31,	
(Dollars in millions except volumes and per loan amounts)	**2011**	**2010**
AFC revenue		
Interest and fee income	**$ 40.1**	$ 29.5
Other revenue	**0.9**	
Provision for credit losses	**(2.5)**	(3.5)
Total AFC revenue	**38.5**	26.0
Cost of services*	**7.7**	6.5