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KAR Auction Services Inc Sale of ADESA US Physical Auction Business to Carvana Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and thank you for standing by. Welcome to the KAR Auction Series Inc. Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. (Operator Instructions) At this time, I would like to turn the conference over to Mr. Eric Loughmiller. Sir, please begin.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

Thank you. Good morning, everyone, and thank you for joining us today for our conference call. Today, we will discuss our announcement to sell the ADESA U.S. physical auction business to Carvana. After concluding our commentary, we will take questions from participants. We have scheduled this call for 30 minutes and hope to get all of your questions in during that time frame.

Before Peter kicks off our discussion, I would like to remind you that this conference call contains forward-looking statements within the meaning of the safe harbor provision of the Private Securities Litigation Reform Act of 1995. Investors are cautioned that such forward-looking statements involve risks and uncertainties that may affect KAR's business, prospects and results of operations, and such risks are fully detailed in our SEC filings. In providing forward-looking statements, the company expressly disclaims any obligation to update these statements.

Now I'd like to turn this call over to KAR Global's CEO, Peter Kelly. Peter?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Thank you, Eric, and good morning, everybody. It's great to be with you all here this morning. We appreciate you joining this call at short notice. So on this morning's call, I have a short presentation to review, after which Eric and I hope to be able to take some of your questions. And I presume and I hope you've all had the opportunity to read the press release announcing our definitive agreement with Carvana that they will acquire our ADESA U.S. physical auction business for $2.2 billion.

And I would just start by saying this is a historic transaction for KAR. I believe it's a transaction that will be transformative for our company, for our customers, for employees and our stockholders. In fact, I think it's fair to say that not only is this transaction transformative change for KAR, but it's actually a transformative change for our industry as well.

So as I said during our Analyst Day and on previous earnings calls and other discussions, we believe in a digital future for our industry. All the trends that we're seeing and experience in our business support that belief, and I'll touch on that more in a moment. I would say that KAR has always been a leader in the digital transformation of our industry, and we believe that this transaction will help us maintain and extend that leadership position. The transaction advances our vision, which is shown on this slide here to build the world's greatest digital marketplaces for used vehicles. We've coalesced on that vision over the last 12 months, and that's at the heart of our strategy and what we plan to do for our customers and the investments we plan to make in our business.

By simplifying our business, we will focus those investments, our energy and our people on delivering the solutions and the platforms that are the most strategic and the most important to our customers. And as we stated in the announcement, the transaction will also

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enhance our financial profile, eliminating nearly all of our corporate debt, streamlining our operating structure and enabling a faster long-term growth rate at KAR.

So when you add all of this up, I believe that this transaction, when finalized, will position KAR to lead and win in the fastest-growing segments of our industry. I'd also say that this belief in the digital future is grounded in the trends that are apparent across not just our industry, but I would say all industries. Truth is we just live in an increasingly digital world. Consumer patterns are changing, and this drives business patterns to change. And this is very apparent when you look at the changes in how used vehicles are bought and sold, both at the retail level and at the wholesale level, and yesterday's transaction gets to both of those marketplaces.

In our own wholesale business, we've observed that over the last decade or so, commercial seller volumes have migrated towards digital channels. This has been easy to see on platforms like OPENLANE, where last year, some of our customers sold 90% of their vehicles through that digital upstream platform. We're seeing a similar trend now occurring perhaps even more rapidly on the dealer consignment side of the business. Digital platforms like BacklotCars, TradeRev and CARWAVE growing strongly, double-digit growth per annum and shifting more volume and more market share towards those digital platforms.

COVID has certainly accelerated those trends. But fundamentally, we still believe we're in the early stages of our industry's digital transformation. So we believe that the opportunity ahead of our -- for our company is very, very large and gaining momentum. From a strategic perspective, this transaction positions us at the helm of this significant change in our industry. Our digital marketplaces provide low-cost, highly efficient venues for our sellers and our buyers to transact. And as we've said before many times, we believe that the digital model increases the total addressable market for our services.

Our leading digital brands, our platforms and technology will fuel our growth as this digital penetration continues to increase. And that's going to be the focus of our company, our investments, our products, our operations and our people. And that's what we believe will generate the greatest benefits for our customers and ultimately deliver the greatest shareholder value to our investors.

So with that, let me move through the slide so we can explain the transaction and talk about the strategy or the impacts on our company and so forth. So first, just to address the transaction itself. It's an all-cash deal, $2.2 billion for the sale of the ADESA U.S. physical auction business to Carvana. The proceeds, net of taxes and fees, we expect to be about $1.65 billion. We intend to use those proceeds to pay down debt and substantially delever our balance sheet to almost a 0 debt situation.

The deal also includes a commercial service agreement with Carvana, where we will provide certain technologies and marketplace solutions to Carvana over a 7-year term. We expect this deal to close within the second quarter of this year, subject to the customary closing conditions. The 30-day waiting period under the HSR Hart-Scott Rodino Act has already expired, expired yesterday, I believe.

So the rationale for this transaction. We see it as a divestiture of a higher fixed cost physical auction business, a strong business and a business that was profitable but nevertheless, a higher fixed cost business. The use of proceeds repays debt, thereby enhancing our financial flexibility and enabling us to invest further in growth and creating more strategic options for our company. It absolutely catalyzes our transition as a business to a more asset-light and lower overhead operating model. And to put some perspective on that, this transaction represents almost half of our total employees, and I believe approximately 1/3 of our total SG&A.

It adds an important new customer relationship toward KAR's digital platform, joining many of the largest players in our industry who are already customers of our technology solutions. And I believe it solidifies KAR's position as the digital marketplace -- as a digital marketplace leader with a large and high-growth market opportunity. So these are the fundamental rationale for the transaction.

If we look at KAR Global after this transaction closes, what are its principal components? I think at our core, we're a digital marketplace business with operations that are principally North American. And if we look within that, we are the leader in commercial off-premise digital marketplaces with our OPENLANE business serving the majority of automotive manufacturers in North America and the majority of off-lease vehicles in a digital off-premise model.

We're also a leader in digital off-premise dealer transactions with our BacklotCars, TradeRev and CARWAVE brands, brands that are

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growing fast, delivering increased volume and increased revenues and profits to our company and creating increased value for customers. So we're a leader in that segment, too. And also we're a leader in the Canadian wholesale marketplace with TradeRev and ADESA both #1 in their respective categories.

We also have international wholesale used vehicle marketplaces that are digital in nature in both the U.K. and in Europe. And finally, we have our AFC floor plan financing business, a strong performer, has been performing very well over the last number of years and a strong cash generator in our business.

When we talk about the impact of this transaction on our financial profile, and we will share more details on this after the transaction closes and in other communications. But if I just sort of anchor on some of the metrics that we had put out with respect to our 2025 Analyst Day, this transaction enhances just about all of the key metrics that we might think of when we think of this company's ability to grow and deliver improved performance for investors. Revenue growth will be higher with this transaction, obviously, off a smaller base initially, but with a higher growth rate because fundamentally, we're leaning into that part of the business that is demonstrating the highest revenue growth today.

Our gross margins will be higher. They were already strong at about 50% of net revenue. We believe our gross margin profile will be even stronger than that. Our adjusted EBITDA margin, we believe, will be higher with this business because at scale, these digital platforms deliver higher adjusted EBITDA margins than the higher fixed cost physical business. And finally, the annual growth rate in adjusted EBITDA, our ability to grow earnings year after year, we believe will be higher under this new model.

The estimated EBITDA impact of the transaction in the current year, we estimate that our current year EBITDA, 2022 EBITDA, and I know we haven't given guidance and we're not giving guidance today, but we estimate that our EBITDA this year will be approximately $100 million lower than it would be had we not done this transaction. And that $100 million is derived by the adjusted EBITDA impact of the business we're selling, but then there's adjusted for revenue through the commercial service agreement that we will have with Carvana. That is a fairly modest sum, I will say, in the current year. So that's not a very significant amount. And then also adjusted for the elimination of any stranded costs that are not required post transaction.

And again, I would say that number in the current year is relatively modest because it will likely take a little time to address some of those stranded costs in certain parts of the business. So we won't really see the full benefit of that til 2023, I would say. But we estimate a $100 million reduction in current year adjusted EBITDA owing to this transaction.

In terms of our next steps, obviously, we put a lot of work in to get the transaction to this point and get a definitive agreement signed yesterday. We're very pleased with the work that was done there by our team and by Carvana and their team. We're now focused on getting the transaction closed. As I mentioned, we already have approval under the Hart-Scott-Rodino Act, but obviously, there are other closing activities that need to take place. We're focused on communication to our customers, to employees, to business partners and also to investors. We will be providing further communications and further updates. Certainly, we'll provide more detail on the next earnings call. But I also look forward to I wouldn't say a second Analyst Day, but an update of our prior Analyst Day, maybe a shorter meeting where we can update all the key metrics as well as the key strategic changes coming out of this transaction. So we look forward to scheduling that after the transaction is closed as well.

So to summarize. When I think of this transaction, I talked about it being a transformative moment for our company and potentially for industry, but if I put the focus back on our company, what does this transaction do for KAR? Clearly, it accelerates our digital marketplace vision. This is a full commitment to a digital marketplace future for our company. We are already a leader. We have industry-leading assets, industry-leading customer relationships. We are going to lean into those and grow and invest in the part of the business that we represent -- that we believe represents the highest opportunity for growth.

That also dovetails, I believe those investments in those platforms also represent us focusing our dollars into the platforms that ultimately are the most strategic long-term platforms for our customers. So investing where our customers find the greatest value. Clearly, it simplifies our business and enables us to lower our fixed cost structure. And I think that's an important accomplishments and important objective in an industry where volumes are in flux between a, if you say, a higher fixed cost, more physical model and lower

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asset-light, lower fixed cost asset like digital model. So addressing that fixed cost structure and streamlining the business, I think, is a real important win for the company.

As I mentioned, it enhances our financial profile when we look at revenue growth rates, EBITDA growth rates, but also margins, gross profit margins and EBITDA margins. And ultimately, we believe this transaction creates obviously, customer value, but helps unlock significant shareholder value. And obviously, that's at the heart of our thinking when it comes to doing any transaction like this.

So I believe that's the end of my materials. I'm happy to open it up, Howard, if you don't mind opening up to Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question or comment comes from the line of Ryan Brinkman from JPMorgan.

Ryan J. Brinkman ***JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst***

Congratulations. Very interesting transaction, seems quite the narrative flip really. So a few questions. Starting with the $100 million adjusted EBITDA impact. I mean I think that's surprisingly low amount for most of the investors looking at this. I guess you've never really disaggregated what is the profit contribution from OPENLANE or other sources versus the physical auctions. And I guess we have sort of a couple of numbers to think about. There's the headwind associated with all the profits at those actions, but then also the tailwind from the commercial services agreements now with Carvana. So can you just maybe just start by helping us with what is the modeling impact in terms of the revenue or that -- I know you've given us a net headwind number, but any sort of additional detail on sort of the financial impact to the operations revenue and EBITDA in the movie pieces within that?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

I'll take a stab at that, Ryan. Thank you for that. And then, Eric, you may have to step in to add some more detail, if I missed anything. So Ryan, I believe, from a revenue standpoint, the revenue impact is approximately, I believe, $800 million in the current year. And Eric may correct me if I'm wrong. And the adjusted EBITDA impact in the current year are approximately $100 million. As I mentioned, that $100 million is a combination of 3 numbers, the EBITDA of the business, which is the significant majority of that number, I would say, by far. And then revenue from the commercial service agreement, which is a modest sum in the current year. And stranded costs, which is an even more modest sum in the current year, but obviously, some benefit, we think, over time there as well.

We've talked a lot about the headwinds in future -- on past calls, Ryan, so you're familiar with that narrative. So you can imagine that the EBITDA performance this year, given the low volumes, certainly, it's not the strongest that it's ever been, right? Because it's tied to the volumes. And this year, as we've talked about, we're starting the year with relatively lower volumes. So the business has performed at higher levels in the past and may perform at higher levels in the future. But the impact in the current year is as we've stated here.

Ryan J. Brinkman ***JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst***

Okay. Great. And just a follow up on that on the 7-year services agreement. So I imagine that offsetting tailwind of what they're paying toward you that would expire at the end of the 7 years. Are they able to exit before the 7 years if they so choose? Or what are the details on that part?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

We've got a -- I want to keep certainly the financial details, the customer relationship, and we don't talk publicly about the financial aspects of any customer relationship. But we have a commitment that we'll provide technology services over a 7-year term, and I believe they're committed to use those services for that entire 7-year term. So we feel good about that relationship, but I don't want to speak to the particular financial details of it on today's call.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

And Peter, we'd like to add 7 years is the term. It's our expectation that if we deliver the services, it would go well beyond that, like it does with many of our private label clients and our technology clients.

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Ryan J. Brinkman ***JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst***

Okay. Great to hear it. And I wanted to ask you, if you think there are any potential benefits to the remaining part of your business from having separated from the physical auction. So for example, I know today already a very large minority of AFC's business is with non-ADESA options. But just curious if maybe that would potentially increase as a result of this transaction. And then also, I know you offer some of the services and some of the smaller acquisitions you've done for independent auctions, et cetera, if you're seeing this being maybe a more independent participant, I don't know if there are any knock-on benefits to the remaining company. Did you see anything there?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Ryan, it's interesting. I actually do see some potential areas of opportunity and benefit through if we think of ourselves as a digital marketplace and digital technology provider, but somewhat neutrally positioned within the industry as that create new opportunities. I think it does. I don't know that any of them are going to be massively transformational in the near term, but we certainly have some product ideas and some service ideas that we're going to be digging into here in the aftermath of this announcement of this transaction. We're going to be looking hard at our strategy and our product road map with that in mind.

So I do think there are some opportunities for sure, Ryan, and look forward to maybe as we as those crystallize and become more concrete, talking about those on future calls.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

And Ryan, relative to AFC, AFC will retain its presence at the locations and be an important source of liquidity for customers as Carvana begins operating a physical auction wholesale business. It remains an important part of their offering, and that's been negotiated so they have access to that as they do now.

Ryan J. Brinkman ***JPMorgan Chase & Co, Research Division - Senior Equity Research Analyst***

Okay. Great. So the last question is just around sort of strategy regarding the pro forma capital structure. I mean after this transaction, you're essentially a technology company, a software company and services company. Those companies, a lot of them tend to not operate with the same degree of net debt, et cetera, and with larger cash position. Just curious how you sort of see the capital structure constituted. And then the strategy for -- within the context of that, and maybe you can comment on the cash flows that the RemainCo might be generating? And would you be using that or potentially leverage also relevering to continue to consummate the type of acquisitions on the nonphysical side that you've been making in recent years.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Ryan, what I'd say to that, first of all, I think the immediate use of proceeds is to pay down debt. I think the business has an opportunity to sort of take on some additional leverage if we so decided. But I would see us keeping it at a much more conservative ratio than we've had in the past. And we'll have that discussion with our Board, and we'll make the best -- I'm not communicating anything on that front here today. But I do agree with your sort of positioning the company as a more technology, more digital, more asset-light and ultimately lower levered company. That doesn't necessarily mean 0. I think the cash flows of the business will be very strong. We look forward to talking about that again in more detail in a future meeting. But I think this is a business that not only is growing but it's profitable, generates cash, and we'll continue to do that as it grows into the future. So I think that's a very positive situation for our investors. Thank you, Ryan.

Operator

Our next question or comment comes from the line of John Murphy from Bank of America.

John Joseph Murphy ***BofA Securities, Research Division - MD and Lead United States Auto Analyst***

I know you're not giving guidance for this year. But I mean if we kind of think about this as sort of courses in (inaudible), you're basically selling off or about $100 million in EBITDA, which is, give or take, about 25% of what appears to be kind of a depressed run rate EBITDA right now? I mean, obviously, hopefully, EBITDA will improve dramatically over time. Is that kind of a fair way to think about this is that you about are getting $2.2 billion in gross proceeds for about 25% of your EBITDA plus or minus. I mean I'm not telling you to give us a

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$400 million EBITDA forecast for this year. But I mean, it seems like it's a very, very good deal for you. And that $100 million has components of maybe commercial services growing over time and stranded costs being worked down, so it might even be less than that $100 million. Is that an okay way to think about this?

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

So Peter, I'll talk about it.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

So yes, Eric, why don't you go ahead?

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

So John, you've evaluated it properly. And while we're not commenting on an exact percentage relative to what the market expects from us, it would -- the math is correct that you just provided. And you are correct, we feel that we got a real strategic value for the business, but we also feel that the buyer had a significant strategic value to owning this property and having a higher use for relative to their business compared to what we're doing. The 1 thing that I'd point out, Peter, and it's important, we have said the use of our properties would evolve over time as we became more digital, and this accelerates the evolution of those properties focusing on reconditioning, focusing on logistics, but also maintaining an auction business as well. So Peter, you might go into that last part a little bit with our investors.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Yes. Thanks, Eric. I agree with Eric's comment. Obviously, I'm focused principally on what this opportunity represents for KAR, but I also believe it represents an incredible opportunity for Carvana. I really think of this deal truly as a win-win that creates huge opportunity for both businesses and for the customers of both businesses. I mean fundamentally, Carvana has just acquired a nationwide network of facilities and capabilities that enables them to expand their geographic footprint in just about every major market in the United States. And they're also getting a truly remarkable team with the ADESA team, a team that's passionate about customers, passionate about service, and just a great, great team.

So I really think this is a win-win. I do think Eric is correct. It's sort of a higher and better use type calculation that is part of this transaction. And I think it's consistent with the strategies of both companies, ours towards a more digital future. And obviously, Carvana they talked about in terms of scaling their business well into the future.

John Joseph Murphy ***BofA Securities, Research Division - MD and Lead United States Auto Analyst***

Yes. No, I agree with you guys. It seems like Garcia understands the value of what your assets were better than the market did and you paid a fair price for it, I mean, it seems like from their side, it's a good deal as well. The second question is just on the digital efforts. I mean there was kind of always this idea that you would run customers through the funnel and drop down ultimately to the physical auction, and they were somewhat intertwined as a package of services to your customers. But now you're not going to be dropping down to that physical end of the funnel.

So I mean, how much of an impact will that have on your digital business? And do you think that so much is just going to get caught further up in the funnel and the digital our networks or your digital network, that's not even really the way to think about the business anymore. It's just morphing more up-funnel to digital.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Yes. Good question, John. I'm not saying there's 0 impact, but I think the impact there is very, very little. So for example, when I think about the OPENLANE business, like almost 0% of the cars that sell on OPENLANE are sold from our physical locations. It truly is an off-premise channel. And then at the end of OPENLANE, waterfall or funnel, as we like to call it, there's a breakpoint at which cars that are transmitted to physical locations. But sellers make that decision sort of independently. They don't send all the vehicles to ADESA just because they're using our upstream platform. right? And then if we look over on the dealer consignment side of the business with BacklotCars and TradeRev in Canada, it's very similar. There is a very small percentage, single-digit percentage of vehicles that may be

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sold from the physical locations through those platforms, but it's relatively miniscule. So I'm not saying there's 0 flow through, but it's a pretty small flow through in reality. And I think ultimately, we see volumes just continuing to grow on those digital off-premise platforms.

John Joseph Murphy ***BofA Securities, Research Division - MD and Lead United States Auto Analyst***

Got you. And then just last quick question. Was this a competitive process? Were there other bidders involved? Is there any -- I mean, are we locked and loaded in this? Or is this did somebody else coming in? I'm just curious in the process, was it competitive? And what are your thoughts on -- I mean, a company like CarMax would be the other natural on this.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

This was a direct negotiation between the 2 companies, John.

Operator

Our next question or comment comes from the line of Craig Kennison from Baird.

Craig R. Kennison ***Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst***

Congratulations. I'm curious about reconditioning. Is there any need for reconditioning on your go-forward platform? And if so, how do you plan to provide that service?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Craig, I think one of the aspects of the off-premise model is that reconditioning is not part of the services offered. So I don't see a massive need, and I don't see us building out reconditioning facilities to deliver that for our customers. I think the majority of vehicles, again, as I mentioned to say on OPENLANE, some sellers selling 90% of their vehicles through that platform in the past 12 months. None of those vehicles are reconditioned. So dealers will buy them and then do the reconditioning at their own facilities, and obviously, some flow to physical auction where they can be reconditioned there. So that's not a business we're going to be in, in the United States after this transaction. But we think the market opportunity is massive in spite of that, let's just say.

Craig R. Kennison ***Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst***

Sure. And as you look at your digital platform going forward, do you feel like you have all the assets you need and all the presence you need across the United States in order to compete in that market? Or with a clean balance sheet, could you consolidate further in the other digital platforms?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

So Craig, I think I'm generally pleased with the assets we have. Obviously, we talked on our last call -- earnings call last week about the integration of CARWAVE and BacklotCars. We have work to do to integrate the acquisitions we've done. So we're very focused on that. And I think we've got a good marketplace presence with a nationwide footprint in the United States and Canada that we feel really good about. Obviously, we continue to look at the landscape in terms of what technologies or offerings might be accretive and beneficial. And again, there's nothing on the radar screen right now.

But I would say I'd be more focused on maybe enabling services that enable the digital marketplace vision rather than marketplaces themselves. I think we've got the marketplace presence. But then you think of, well, are there inspection technologies? Are there logistics technologies? Are there things like that, that might deliver a greater customer experience in that digital pure-play model? And again, nothing to comment on here, nothing being worked on, but we'd always just be very focused on just the solutions that we have and making sure it's best in class. Let's just put it that way.

Craig R. Kennison ***Robert W. Baird & Co. Incorporated, Research Division - Director of Research Operations and Senior Research Analyst***

Sure. And lastly, on AFC, just from a modeling perspective, what are the implications for the size of that portfolio, given this transaction?

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Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

I don't think there's a significant implication there, but I'll let Eric comment here in a second. The way the AFC business works is a dealer elects to do their floor planning with AFC. And then because of that relationship, then the dealer will want to use AFC floor planning, every place he or she buys vehicles. whether that's a Manheim auction or the auction a digital auction or local independent auction. So the AFC business is really sort of tied to winning the dealer's business at the dealership level as opposed to winning the dealer's business at the sort of checkout level when he just happens to buy a car. You win the relationship as the dealers floor plan finance company and then the dealer floor plans all their vehicles on that platform. So we don't see an impact there. Eric, I don't know if you want to add to that?

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

No. Just for Craig's benefit, we see no disruption to the growth that they've been experiencing after bottoming out in 2020. And in fact, we increased the capacity of the securitization earlier this year, and we intend to -- as we normally do towards the end of the year, we'll be looking at our facility going forward, and it looks like our capacity may grow again as we near the end of the year in terms of securitization, and that's because it's funding growth that we think will continue.

Operator

Our next question or comment comes from the line of Gary Prestopino from Barrington Research.

Gary Frank Prestopino ***Barrington Research Associates, Inc., Research Division - MD***

Great transaction here. A couple of questions. First of all, with that preferred instrument that you guys issued during the pandemic, I think the conversion rate on that was $17 a share. Do you have -- is that correct? And can you actually force conversion of that instrument?

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

So Gary, let me handle that. The conversion price is $17.75, and the provisions of the agreement, we cannot force conversion at this time. And -- but there are points in the future when -- if the stock price is at a certain level for a certain length of time where that could happen.

Gary Frank Prestopino ***Barrington Research Associates, Inc., Research Division - MD***

Okay. So it's up to the entity that owns it if they want to convert the stock? Okay. And then secondly...

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

Yes, generally for the first 3 years.

Gary Frank Prestopino ***Barrington Research Associates, Inc., Research Division - MD***

Great. And just to get an idea of the rationale for keeping AFC, how much of what you did in the digital dealer-to-dealer and as well as through OPENLANE was actually a floor plan through AFC? Was that a rather substantial percentage of the vehicles going through the digital platform?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Gary, it's a relatively modest percentage. I guess what I would say is when a dealer is buying a vehicle on, say, BacklotCars, they're probably floor planning the vehicle, I don't know, 40%, 50% of the time and AFC is picking up its share of those transactions. So maybe 13%, 15%, 16% of the transaction, something like that. We've been working on increasing that attach rate over time. It hasn't increased over time, but it's in the 10% to 20%, let's say, range is where it's been historically.

Gary Frank Prestopino ***Barrington Research Associates, Inc., Research Division - MD***

So then -- so I guess the question I would have is in this transaction, what is the real rationale for keeping AFC? Because it appears to me that it's going to be AFC's paper that's going to be backing the Carvana transaction -- physical transactions.

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Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

Gary, as you look at that, AFC backstops all kinds of auction transactions. I mean, again, it's a provider to the industry. And ironically, Peter, you asked about our digital platforms BacklotCars we are increasing our share relative to alternative floor plan lenders because we get to see who we're collecting from and it's a floor plan lender. So I see no change there. And we provide floor planning for dealers that other retailers who happen to run auction platforms. And so it's -- I really just don't see a change there. And retaining AFC is because it's such a strong business model, it really is a powerful tool for our customers to have access to liquidity.

Now again, the franchise dealers generally have it. This serves an independent dealer population that again represents probably 35,000 dealers in the U.S. and Canada that we can provide comparable liquidity to what the captive finance companies provide to the franchise dealers. So I think it's a really powerful business that we're very interested in having part of our capabilities for the dealers.

Operator

Our next question or comment comes from the line of Stephanie Moore from Truist.

Stephanie Lynn Moore ***Truist Securities, Inc., Research Division - VP***

Congrats on the transaction.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Thank you, Stephanie.

Stephanie Lynn Moore ***Truist Securities, Inc., Research Division - VP***

I wanted to touch on -- so the pro forma business here, so ex the physical assets, now we're obviously taking a much more acute focus on certain businesses here versus overarching KAR previously. So I think it would be helpful if maybe you could frame some of the headwinds and tailwinds of the pro forma business, maybe kind of talk through what the industry or macro headwinds and tailwinds and then maybe some of the more investments or what's in your control as you look at the pro forma business?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Thanks, Stephanie. I'll attempt to shed some light on that. And I guess I'll start by saying, I actually see at the present moment more tailwinds and headwinds, more tailwinds and headwinds. I think on previous calls, we've talked about a recovery in volume that we expect to happen and how that will be beneficial. I think it will be beneficial for the business we're selling, but it will be beneficial for the business we're keeping as well. I want to be clear about that. So as commercial volumes recover, that will be very positive for our OPENLANE business, for example. As more new vehicles are produced and sold, that will create more trade-in volume that will be very positive for BacklotCars CARWAVE, TradeRev and so forth.

So I think those sort of industry dynamics coming out of a sort of a depressed volume moment, which is the last half year and maybe the next -- this quarter and the next quarter, perhaps, I do think we're going to see some volume recovery that's going to lift KAR but also ADESA. So we've got that going on.

Then on top of that, I think we've got some revenue and monetization opportunities, particularly on the dealer -- digital dealer consignment side of the business. We've talked about that on prior calls with BacklotCars in particular. So growing our volume, but also growing our ability to monetize every transaction. And then I think this transaction, as we've said, it simplifies our business, enables us to lower our cost structure, reduce our overhead and really focus our investments on what are the most strategic platforms to our customers.

So we're going to be able to focus those investments and be more efficient in terms of the things we choose to invest in. So I take that as a positive, too.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

And Peter -- and Stephanie, one more tailwind, and people will remember that about 45% of our capital expenditures have been in the physical side of the business and 55 -- over 50% has been for technology. This will actually reduce the CapEx requirements. We'll still

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have them in Canada, but there'll be a much smaller portion giving us the flexibility to deploy capital, as Peter said in his remarks, to the fastest-growing portion of our marketplaces, which is the digital element. So that is 1 real positive out of this is again, as an earlier question indicated, the reduction in adjusted EBITDA is disproportionate relative to the value credit here, but also it frees up capital maybe for a better use in our digital marketplace business as well.

Stephanie Lynn Moore ***Truist Securities, Inc., Research Division - VP***

Got it. So I guess just to take that a step further, I mean, we -- in theory, that means you're freeing up capital so the investments required as we look forward, we really shouldn't expect those to be an incremental headwind as we think of prior years.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

I don't think so.

Stephanie Lynn Moore ***Truist Securities, Inc., Research Division - VP***

And then, okay, lastly for me, and maybe I'm just not as familiar with the commercial service agreement, can you -- and I know you don't want to talk about customers. So can you give us maybe broad examples of how this might work this year and the coming years? Just so I can have a -- we can have a better understanding. Again, I realize you don't want to give too much, but just so we kind of understand the framework.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Well, let me give you a simple example, Stephanie, of 1 element of it. We acquired Auction Frontier last year. Auction Frontier provide simulcast services to many customers across this industry, obviously, ADESA, but also independent auctions also -- I don't know I probably shouldn't name customers by name, so I'll hold off. But let's say, multiple entities across this industry that run automotive auctions.

Well, Carvana becomes a customer of that service with this transaction. We will continue to provide that simulcast service for that for Carvana as they run the ADESA U.S. physical auction business. And that obviously represents continuity for the customers because that's the simulcasting solution that we use today. But that piece of technology isn't going with the transaction. It remains here at KAR and is covered under the commercial service agreements with Carvana. So it's examples like that.

Stephanie Lynn Moore ***Truist Securities, Inc., Research Division - VP***

And I guess, is it something where this is paid on an annual basis or quarterly based on volumes? I guess I'm more just trying to think about it from that standpoint, too.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

It's a platform fee per transaction, and that is the pricing structure for the majority of our customers, especially the independent auctions and other entities that run auctions who might be retail operations or other businesses.

Operator

Our next question or comment comes from the line of Bob Labick from CJS Securities.

Daniel Joseph Moore ***CJS Securities, Inc. - MD of Research***

It's actually Dan Moore on for Bob this morning. You touched on this, but maybe you could go into a little bit more detail around the go-to-market strategy on a go-forward basis for BacklotCars.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Thank you, Dan. The go-to-market strategy doesn't really change that much. BacklotCars was obviously independent of KAR just a little over 12 months ago, and grew its business substantially as an independent business. It's been part of KAR now for about 15 months. We've been going to market directly to dealers, obviously, leveraging in some cases, the ADESA relationship as well. That's been a collaborative effort, continue to grow the business that way.

We've expanded the seller base and the buyer base significantly. We know who all the dealers are, franchise dealers using OPENLANE,

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independent dealers using AFC. So we just will deal directly with our dealers and speak to them about the benefits of these solutions and platforms and how they can enhance their business and obviously deliver great service and earn their business that way. So the go-to-market doesn't change that much.

But what I would say is our focus does change, and we are no longer sort of indifferent as to well, the car could sell here or there, and we get a transaction, and that's okay. Our focus is clearly, we want to grow BacklotCars. We want to grow OPENLANE, we want to grow those platforms. I believe that aligns with our customers want to do in many cases, and we want to grow and win in those markets.

Daniel Joseph Moore ***CJS Securities, Inc. - MD of Research***

Super helpful. Appreciate it. And then can you give us a sense for how big the combined sales force is? And how much of that stays with RemainCo?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

I don't have precise numbers. What we have done for the most part is the sales team, both on the commercial seller side and the dealer side who are most tied or focused on the ADESA physical auction business in the U.S. will go with the transaction, and the sales force that was most focused on the off-premise platforms, OPENLANE BacklotCars both on the seller side and on the buyer side will remain with KAR. And I don't have precise numbers, but that's the...

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

Let me help there. The sales force for the likes of BacklotCars and TradeRev was larger than the sales force for the physical properties. So a larger portion of the sales force stays with us also was in the cost structures of those enterprises.

Daniel Joseph Moore ***CJS Securities, Inc. - MD of Research***

That's helpful. Lastly, you talked about some of this was asked, but any additional divestitures. You talked about potential M&A. Any additional likely or potential divestitures to follow?

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Yes, Dan, nothing to speak of today, for sure. I guess what I would say is, I talked about our vision statement, and that's the vision of the company. And I want to make sure we have the right assets to go execute that vision. And we will obviously be doing our own assessment with the management team as we close this transaction as to how we continue to grow this business and deliver the results and performance that our customers expect and our shareholders expect. So if there are to be any changes, we'll comment at the time, but nothing to comment on today.

Eric M. Loughmiller ***KAR Auction Services, Inc. - Executive VP & CFO***

So Howard, we are running out of time. For our investors on the call, if there are more questions, please contact Mike Eliason, Vice President of Investor Relations; or myself, Eric Loughmiller, CFO. But I think we need to draw this to an end, and Peter has some concluding comments.

Peter J. Kelly ***KAR Auction Services, Inc. - CEO & Director***

Well, again, thank you this morning for joining. Thank you all for joining us here this morning. We're excited about the transaction. Obviously, our team put a lot of work to get it to its current state. I want to thank the team that worked on the transaction. Again, I do see this as a win-win. I see it as a win for KAR and a win for Carvana and a transformational transaction for our company. It's obviously with mixed feelings that we will be parting from the ADESA team in the U.S. As I mentioned, it's a great team and a really customer-first culture that has set ADESA apart through its entire history. And I guess my commitment here is that, that same customer-first culture and customer-first approach is what animates all of us at KAR, and that's going to continue to be part of our culture here as we grow our business in this more digital marketplace future. So we're excited about that. We look forward to further discussions and further updates. Again, thanks for your participation and your questions, and we will be in touch again in future calls and in future updates. Have a great Friday and a great weekend. Thank you.

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Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect. Everyone, have a wonderful day.

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