Doug: Hi, everybody. Thanks so much for joining us. Again, Doug Karson here with Bank of America. We're so delighted to have KAR Auction Services with us today, and with us from the company we have CFO Eric Loughmiller, and we're going to have about 30 minutes of fireside chat format. We'll be getting some questions from investors that'll be dialing in, but I'm going to be hosting the first few topics. Thank you, Eric, for joining us. We really appreciate it and all your support for all these years.

I wanted to start by talking about the very strong margins the company has boasted over this very challenging environment. If you could talk to us about margins and maybe we can weave in the cost of reducing some of the SG&A costs that has been targeted as an opportunity.

Eric: Thanks, Doug, and thanks for having us today. It's nice to come to a leverage conference instead of an equity conference because we can focus on the things that are positive here about our business. First and foremost, while the pandemic created a lot of challenges for us and everyone else, it gave us an opportunity. It accelerated the conversion of what was historically a very physical auction environment very quickly into a digital transformation where we're selling all of our cars digitally.

Now even prior to the pandemic, we were offering all of our cars in a digital format, but a lot of the buyers would come to the auction and try to transact live and in person. That didn't happen in 2020 and so we accelerated the transformation of the business to a digital model, and in doing so we eliminated about 5,000 direct labor positions throughout the company.

We eliminated some SG&A as we were able to get more efficient using the technology, and that's resulted in gross profit per unit increasing to, most recent quarter was $274 per transaction in the ADESA segment, and we've been able to reduce the SG&A. We took about $150 million of annual labor cost out. About two-thirds of it was direct labor and one-third of it was SG&A.

And then as Doug mentioned, I don't think we're done. We had an analyst day in September. We talked about an opportunity to continue reengineering our processes. Well, we've taken the format of the auction into a digital frontend. We now have to get the backend to follow that, and so we've got some technology enhancements that would allow us to further reduce what I call the administrative cost of processing these transactions.

We look forward to it. In the analyst day materials, we've identified over the next few years $30 million in reductions in SG&A compared to the current run rate that we think we can achieve, again, through process reengineering.

Doug: That's very helpful, excellent. If we could just talk maybe about the migration we've seen to online transactions versus the standard way we use to do business before. How's that migration been?

Eric: Again, this is one thing COVID did for us. It accelerated the pace of change to a great extent. And Doug, when I say that, we were closed down. We were not allowed to have buyers in the auction arenas. It's too close contact. This was, again, over a year ago. If you wanted to get access to inventory – and while things pretty much shut down end of March, first of April 2020 – they quickly went back to where automobile sales really were strong.

They started picking up in the middle of May and got extremely strong through the summer months, continued strong. Had a little weakness in the fourth quarter of '20, and then picked up right where we left off, and now we have a situation where there's no inventory. Dealers are constantly looking for the vehicles that they can put on a used car lot.

Well, when we shut down, the only way they could get inventory was to go into digital formats, and the good news is KAR was, in my view, a leader in becoming a digital enterprise. We had committed about 2016 to a digital future. We said our strategy was to lead a transformation of an industry that had been heavily dependent on physical auctions into a digital marketplace format, and this accelerated the pace of change.

Now interestingly enough, and this probably applies to a number of businesses, COVID caused this change to really come forward and everything went digital in a matter of weeks in order for the business to go back. Here we are starting to say, get past some of that shock of COVID. While things aren't fully open, there's generally business as usual. It did not accelerate everybody quite as much as we would have liked to.

While we may have taken a five, ten-year transformation and moved it into five to ten weeks, we are now learning that not everybody is committed to the digital transformation. We started running vehicles through the physical lanes in 30 locations in the United States. None in Canada. That focus has been on lower value vehicles and lower value repossession vehicles to the extent that the sellers prefer to have the car run across the block to demonstrate that the car is operational.

We are willing to do that at certain locations with the right mix of vehicles. Interestingly enough, when we run those vehicles, over 60% are still acquired by buyers who are online. They are not in person. It isn't as if this isn't a digital process. It is, but it appears on certain vehicles less than $7,000 is what our tech

data says, there is an advantage to actually bring the car running through an auction lane.

Again, the digital transformation is real. We think it will continue to be increasingly digital in the wholesale used car auction business, but it's not 100% digital yet.

Doug: I'd like to ask a question about CARWAVE and BacklotCars and TradeRev and a bunch of exciting combinations here. If we could kind of talk about some of the rationale behind those.

Eric: It's very interesting that in 2011 we acquired OPENLANE and committed to a digital format feeling like that's how off lease cars would transact. Then in 2015, we invested in TradeRev. We subsequently acquired 100% of TradeRev. In 2020, in the midst of COVID, we added BacklotCars. TradeRev and BacklotCars and now CARWAVE are all digital dealer-to-dealer marketplaces.

TradeRev was founded in Canada, and we introduced it into the U.S. marketplaces. BacklotCars was founded in Kansas City, had a focus on the central part of the United States. Really, in Kansas City and growing outward from there. CARWAVE was a digital dealer-to-dealer marketplace that started in California and has had great success on the west coast.

What we've done is combine those. We're integrating all three in the U.S. onto a single platform, and the goal here is to have the largest buyer and seller base on a single platform in the digital dealer-to-dealer space. The technology is different in each of those, but not a differentiator in our view. What we think is having good technology is required and having a strong go-to-market strategy is critical to success.

We see ourselves being a leader in North America in digital dealer-to-dealer transactions. Our goal is to be the leader in the U.S. We're currently number two and growing at a rapid pace. Not only is this a new way to transact the dealer-to-dealer transaction, but it's also a way to increase the total addressable market in our space. Historically, there have been about 10 million transactions in what we call the formal auction marketplace.

We believe there are 20 to 25 million transactions where cars change hands. In the past, a big portion of those were transacted in informal marketplaces. What we've done is put a technology solution in place, a very efficient marketplace, the car doesn't need to move, very low cost, and we believe this will expand our addressable market from 10 to probably in the neighborhood of 15, maybe a little bit better, 15 million transactions and that's really what we're after.

Can we grow the addressable marketplace by having this efficient, digital marketplace with very low transaction costs around putting that car up for sale and getting it into the hands of another dealer? Again, a reminder for everyone, we are a B2B business. We only operate in the wholesale space. We are not a retail marketplace at all. I'm hearing blank space. Is there a disconnection?

[background conversation]

Doug: Let me switch into, maybe you could talk a little bit about the cashflow and the balance sheet. That'd be really helpful.

Eric: The one thing about our business, and we experienced this back in the great recession, as we've renamed it, for 2009, our business becomes a very high cashflow conversion enterprise. Ironically, there's low inventory. Cars turn very fast. We have a finance company that does floor plan lending. Average days outstanding are reduced. The collateral values have increased. There's very little bad debt.

In fact, in the third quarter on our portfolio of loans, recoveries actually exceeded the bad debt expense for the third quarter of 2021. That's something that just isn't going to happen very often, but it's the type of lending we're doing. With used car values so high – and I'm sure you'll want to get into what's happening there – what that does, it strengthens the transaction, the cash moves quickly, and we are a strong generator of cash. Even in a depressed period of performance where we don't have inventory it does generate a lot of cash.

We have utilized, in 2020 we raised $550 million in a private investment type transaction issuing some preferred stock to shore up the balance sheet. As the markets came back to – we weren't sure what it would be and in fact we raised that amount of money. People asked why that amount? We said we felt we had to have enough capital to get through the end of 2021 feeling like COVID could impact us that long.

We said that at the time and people laughed at us because by June, our markets were hot. I mean, we set records in the month of June and continued strong into the July timeframe and then we ran out of cars. Basically, the industry was cycling inventory that it built up, values were increasing, and as a result, the cash conversion is great, I just don't have enough transactions.

With that said, we've deployed capital by buying BacklotCars and we just acquired CARWAVE. That's increased our net leverage temporarily, but we'll continue to have strong cash generation. Our EBITDA will grow because we're lapping those very poor quarters especially. We're past Q2 of '20, but Q4 of 2020

was the lowest actually performance I think for the company excluding April where everything was shutdown.

In Q4, we'll lap after this quarter, and we'll start to building up EBITDA. Our cash will be generating. Our net debt will decline, and our target leverage is three times or less total leverage on a net basis, and we're comfortable we can get there in a relatively short period of time after the acquisition of CARWAVE and the use of cash. We have not used our line, our revolver, for any of these acquisitions. We've used cash from the balance sheet, and we still are sitting with a little over $200 million of cash on my balance sheet even today.

The balance sheet is in good shape. We have been acquiring back some stock in 2021, not a lot, and that is because I can offset the dilution of the preferred stock issuance from 2020. I've been buying back stock below the $17.75 conversion price. At this point, after these acquisitions, we've said that will not likely be a priority until we, again, reduce our net debt down to less than three times.

Doug: Can you maybe share a little about the pricing environment you've seen in the industry and how sustainable do you think that is and where it will be headed.

Eric: Anyone who has shopped for a new or used car realizes how can this continue? Used car prices are at all-time highs because new car prices are at all-time highs. I mean, I just saw a piece this morning where the average new car price in November is estimated to be $44,000. That's got to be 30 or 40% above the typical average net new car price.

What that does is used car prices have increased, new car prices increased as well. We have a shortage. You can go out and try to buy a used car. You'll find out they're priced extremely high because there's more demand than there is supply. As I look at that, it's going to change. First thing we have to have is we have to have increased production of new cars. We need more inventory on the lots of the franchise dealers, the new car dealers.

When that occurs, you'll start to see them having less used car inventory which will spread it around through the market. We've started to see I think some stabilization if not moderation of pricing on the lower end of the used car market. We're not yet seeing on what I call the upper end, that three year off lease car with less than 40,000 miles that has, again, an average wholesale value of $21,000 right now.

Just to give you an idea, Doug, of these values, in the third quarter, the average auction price on our open lane platform was $21,500. And a year prior to that $21,500, that was $19,000 roughly. When you go to the digital dealer-to-dealer, we were at $10,700. That's a lower value car. That was $8300 a year ago. These

are, we have huge increases in used car values at the wholesale market, and that all gets passed on to the consumer in the retail price.

As I look at this, I look at this and say it's going to come down. Once we stabilize, first we need production. We need off lease cars to have at least equal supply to demand. Right now, there's more demand for those vehicles than there is supply of them. Then that will filter down through all of the used car values that, again, the average car sold in our auctions is probably more like seven to eight years old. It's not the newer vehicle. It'll filter down to that level.

As I look at it, I think prices will start to moderate. It might be well into '22 before we see that, but we're starting to see signs. IHS has indicated new car production is picking up, that most plants are back online here in Q4. That'll help us and we'll just need time for that to work its way through the system. I've read where many of the national retailers are down to 20 days sales and inventory. That number needs to get back up in that 40 to 50 to 60 range and that'll help us, but it'll take time to get there.

But we do see prices moderating throughout '22 into '23 and prices coming down probably by '23 I would expect we would start to be seeing more normal conditions on supply and demand and that would be good for pricing.

Doug: Could you talk to us a little about your long-term leverage targets and potentially what type of ratings that you're looking to maintain.

Eric: Doug, our target is total leverage of three times or less. We have bonds due in '25 that I'm focused on, what will I do with those bonds? The one thing I would tell you, we've not changed our long-term, our target for total leverage of three times or less. However, a digital business model would likely end up with a balance sheet target where you would want less leverage because when you look at technology-oriented business models, marketplace businesses, they typically would have less leverage than that because there's a lot less investment in infrastructure around the physical location.

I'm not saying we're changing our targets now, but we do recognize as we move more digital, it might be a leverage profile where we would target less leverage. Now the good news is that I have $950 million in bonds that come due in 2025, and on our analyst day we indicated that between now and the end of 2025 we expect our businesses to generate $1.5 billion of cash from operations. That will be available to support, looking at our balance sheet and saying what's the right balance sheet mix and leverage amount for the type of business we are operating at that time.

To the extent it's more technology oriented, it is possible that we will consider reducing our leverage target from three times to something less than that. In terms of ratings, our industry being auto related, it's classified by S&P and Moody's in a category where, again, I don't focus as much on that. I mean, again, we tend not to be investment grade no matter what we do and how well we perform, but they do have a stable to positive outlook on us because of our strong cash generation, even through COVID.

We're satisfied with our current ratings and generally the price on our debt has been I would say even better then our rating would indicate. It might be in the marketplace because of our strong cash generation, so it's not been actually a deterrent in the leverage part that's for us. They have the ratings, but we do that.

Doug: Question coming here from the audience, how does the migration to EV and hybrids affect your business?

Eric: You know what? It's interesting, it doesn't really impact our business. We've been handling Teslas in large quantities for a long period of time. Now more and more coming. Again, our facilities, if they are marshalled on our facilities, we have the ability to charge vehicles very quickly. Again, you can be a super user, so super charger is not a big deal. They're not a huge capital investment relative to the numbers of vehicles.

In fact, it's a very efficient process. We can be charging vehicles 24/7 because, to be honest with you, so many vehicles come through our properties. But the EV, the change there is actually how do you handle the batteries? I mean, it has nothing to do with the vehicle itself. Is there going to be a demand for us changing out batteries prior to wholesaling them? At this point, there has not been on any vehicles, and we have to get prepared for that.

But at this point there's been no demand, but we are prepared to respond whenever the markets change and the type of work we're doing on the vehicle changes we'll be ready. We have the space, we have the infrastructure in place, we have the power into the facilities, and it works very well. Again, these are, we have 70 locations throughout North America that are predominantly used for marshalling vehicles, doing reconditioning of the vehicle, preparing them for retail sale, and it's quite an important part of our business, so we're prepared to handle the EV shall we say transition that will occur over the next decade in our opinion.

Also, EVs have been remarkably resilient on retaining value. Now whether that's because of the likes of Tesla controlling supply and demand a little bit, but the EVs ironically do very well in the digital format. There's greater confidence in an electric vehicle then perhaps the internal combustion engine knowing it's

dependability, based on, and again, based upon the batteries and the fact that that's the primary driver.

Over time we'll see if that continues. I don't think there's a long history of EVs to see are there mechanical issues other then the batteries that you have to be able to…

Doug: There's a question [break in audio] expansion into other markets that you're not currently in?

Eric: We're focused on the U.S. right now, digital D2D. That is our primary. Canada, we're in a leadership position, and again, it's easy, it operates very similar to the U.S., so North America is getting a lot of attention. We do operate in Europe, in continental Europe through ADESA Europe and in the UK through ADESA UK. Those are 100% digital platform businesses. We have no physical auction operations, and at this point in time I would say we've deprioritized it temporarily because of the focus on winning in the digital B2B space in North America and in particular the U.S.

But it's an area where we would see ourselves investing in growth over the next five years for sure. Again, though, it'll be a different type of investment then how we built up the North American business, which started as a roll up of physical locations, lots of property, now transforming it into a digital marketplace business. We have started in Europe as a digital marketplace business. We do not focus on physical auctions. It's a very digital enterprise and it's profitable and growing despite the fact that the volumes are down.

Profitability is growing, the economic model is fantastic in Europe, and we see that as an opportunity for us. However, it's an opportunity that we think that we can take advantage of with cash we generate for the businesses as opposed to needing outside capital as of now.

Doug: That makes a lot of sense. Question here, labor has been pretty tight, labor cost has gone up. How have you been able to attract talent and retain talent and afford some of the rising prices of labor?

Eric: Prior to COVID, we had done a study of the lower end of our labor pool in the auctions and found that we had to increase – we could not continue operating with the minimum wage that was in place and going up from that because we started seeing competition for talent with the likes of Amazon hiring, Walmart. Ironically, those are the types of businesses we were competing with for the talent that comes in to drive vehicles.

A lot of people that are at the end of their careers come in and work in our business model driving vehicles. They enjoy it. And so, we've seen labor costs come up, but they were coming up unrelated to COVID. Now with COVID, I think we're better prepared because we've raised the [audio interference] in the field and try to be responsive to competition.

We then eliminated 5,000 positions. Ironically, having less demand for a period of time, it was a good time because it was hard to hire people. Now, one of our initiatives is increasing what we call the retail reconditioning, reconditioning vehicles for the e-retailers so the car can go from our site directly to the consumer's driveway. It doesn't need reconditioning by the likes of CarMax, Carvana, Vroom, Shift, all the e-retailers and the franchise dealers.

For that, we need to increase our reconditioning team. We need to increase the number of employees. It's a challenging environment right now, but these are jobs that have good, stable hours, especially if you're mechanically inclined. So, we feel we can fill all the positions. The wage rates are reasonable relative to the value that we deliver to the customer, so the margins continue to be pretty strong for all of those services.

We've been able to respond to it, but it is a challenge that we're dealing with every day, and that challenge is where do you find the talent pool. And I'll be honest, where we're operating tends to be in areas with large commercial properties around it and we're seeing a lot of competition from the likes of Amazon putting in distribution centers around the areas where we're also, where we've been operating, in many cases, 10, 20, 30 years.

A new competition for talent, but I think we're up to it and we'll be able to get the talent. The labor rates are consistent. Again, it's a high-value service with high productivity, so we can absorb the increased labor costs because we have such high throughput on these sites. It's like a mass production factory. There's no downtime, unlike there might be in a service operation of a dealership or something like that. I think we're in a good spot, but we are hiring, especially as it relates to our recon opportunity for the e-retailers.

Doug: That makes a lot of sense. Thank you so much. It was an excellent overview and presentation. Thank you for digging deep into some of those answers, and without further ado, we'll wrap up the fireside chat with KAR Auction. Thank you so much.

Eric: Thank you, Doug, and thanks, Bank of America, for hosting us.

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