KAR Auction Services

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Chandni Luthra: Good afternoon, everyone. I'm Chandni Luthra, from Goldman Sachs, and I have the pleasure both of introducing a senior management leader of KAR Auction Services and of moderating this fireside chat here today at the Grand Hyatt Hotel in New York.

We are very happy to have you at this conference. You obviously offer a bit of different twist to this event, given that you are a critical B2B player in a consumer ecosystem. For those of you who don't know KAR, KAR is one of the two leading whole-car auction businesses. It recently underwent a huge transformation.

I'm very happy that here with me today I have sitting to my left Eric Loughmiller, the EVP and CFO of KAR Auction Services, who joined the company a bit more than 12 years ago and obviously has been instrumental in transforming the business through the years.

Eric, thank you so much for joining us today. Why don't you give us a little bit of an introduction, given a lot of the investors here might not be familiar with the story?

Eric Loughmiller: Thanks, Chandni. And welcome, everybody. First and foremost, KAR Auction Services went through a major change at the end of June of this year, where we spun off Insurance Auto Auctions, our salvage business. And what's left of KAR is presented on this page.

We have a business with over 74 auction locations in the U.S., Canada, Mexico, and then we offer online auctions in Europe.

Our net revenue in 2018 was $2.4 billion, selling 3.5 million vehicles in the B2B space. Those vehicles had a gross value of over $40 billion. And 59% of our vehicles are sold online, which I think is a theme that a lot of people get into as we're migrating a physical auction business into a technology-based business.

We operate, again, in a B2B network, as Chandni mentioned.

And then I'm going to skip all the way to the back, and the last bit of news, which is fresh, Chandni, from yesterday, is we've announced a refinancing of our Term Loan B. And what we'll be doing is looking at – did I go too far? We'll be refinancing Term Loan B4 and B5. We've announced the launch of a Term Loan B of $950 million. We expect terms to be seven years in duration. We are proposing a $325 million revolver that will be undrawn. The proceeds of this will be used to repay Term Loan B4, B5, and any amounts

outstanding on our revolving credit facility. And we would expect approximately $400 million of cash to then be put on our balance sheet for use for general corporate purposes, especially for strategic investment in growth and mergers and acquisitions that we currently have in our pipeline.

Our target leverage for the business is 3x, or less, and we're very comfortable at that level. We're currently, as you can see, at 2.8x, and this would not increase our net debt as we put the cash on the balance sheet.

So, I thought I'd give you that brief introduction. We've launched that Term Loan B transaction this week, expect it to be completed in the next couple of weeks.

So, Chandni, I'll now let you ask me all the questions.

Chandni Luthra: That sounds great. So, let's take it at the very top. You guys obviously, as you mentioned, went through a huge transformation with the spin-off of IAA. Could you perhaps recap the thought process behind that decision? And then with two months in with the new KAR, give us an overview of the business and what is the biggest investor feedback that you've been getting.

Eric Loughmiller: Sure. Well, thanks for that question. First, there's many reasons to look at a spin, but the primary reason is we felt we could unlock shareholder value that was not being recognized with Insurance Auto Auctions as a component of the KAR business. We were trading at multiples that typically were around 10.5x our adjusted EBITDA, and we had a pure-play competitor in the salvage business that was trading at multiples in the high teens and now even at 21-plus. So, a high valuation.

And so, our thought process was the companies had reached size where they could each stand alone as independent public companies. We had a management team at Insurance Auto Auctions that had been in place for five years, and we felt they had a leadership team that could operate in the public environment. And they were starting to have a business at a level of maturity that required all of the capital it was generating to be used within the business. So, we weren't losing access to capital to support the other businesses, in our view.

So, we completed the spin on June 28. And I think it's been a successful spin, as the Insurance Auto Auctions market cap is running about $6.2 billion or $6.3 billion. We're about $3.6 billion. And that compares to a market cap at the time we made this decision that was at about $6.2 billion or $6.3 billion on a combined basis. So, I think it's obvious we unlocked value.

And it's been two months. We're performing well. As a standalone KAR, though, it allows us also to have a more focused, somewhat less complicated – I use that term probably with air quotes, because it still complicated our revenue model and things – but a somewhat less complicated business that's focused on remarketing vehicles in the B2B space; so, dealer to dealer, captive finance banks to dealers. It's really a B2B business.

And when you look at this business, internally we've assessed what do we do very well, what things. And it really comes down to one thing: we remarket vehicles. And everything else supports our effort to remarket vehicles. And so, we were looking at it and the questions I'm dealing with today, in particular, are, well, how are the changes? We're going through a transformation from what has been known as a physical auction business into a digitally focused business. How are you managing that?

And so, we are sitting here telling you, unlike a lot of this conference where it's retail-oriented, we are leading that transformation. We have developed products. In 2011, we acquired a property called OPENLANE, and we have become the leader in the private-label sales of off-lease vehicles between the captive finance companies and banks to the franchise dealers of their brand, selling over 1.2 million units on that platform last year. And the total sold on private-label sites is probably 1.3 million units a year. So, we have very high share, you might say.

And now we've introduced a product called TradeRev, intended to be selling dealer-to-dealer transactions. And there's a lot of concern because we're losing money in the TradeRev business as it's a startup, but we believe this will be the future and is part of the transformation of the industry and provides an opportunity to actually be more efficient long term once we build that model to scale; very much like we did with OPENLANE, which was at breakeven in 2011, selling 390,000 cars – in 2009, less than 300,000 – in 2011 and breaking even. We think if we can get this business to 350,000 to 400,000 units sold, it can also break even and then grow from there profitably as we look at it.

So, a lot of questions about transformation. It is difficult to take a cash flow-oriented business that has a lot of leverage on its physical assets and to begin introducing new online products that at least in the startup stages is negative to the cash flow. And so, that's been a challenge for our investors to understand it and what's the path to profitability.

Chandni Luthra: So, continuing with that path to profitability, if you could elaborate the economics of TradeRev and how they should evolve over time? And then, what should the long-term earnings potential of that business look like?

Eric Loughmiller: Sure, Chandni, and we'll keep the long term to more high-level business. But in the short term, early this year we were averaging $250 per unit sold on the dealer-to-dealer site. Let me put a slide up that will compare – so, there, you can look at the dealer-to-dealer. It's an average vehicle value of about $8,000. It's the column to the right, right next to "International" and between "Physical."

That compares – and so, I'm getting $250. We have determined that's too low. Our competition in that space is ACV. They're over $300 per car sold. So, we're pleased to report we've been increasing pricing, and at the end of this quarter I'll give you the numbers. But we've gotten that up in the $290s already, and we are targeting an average transaction in auction fees of about $300 per car sold.

Now, you compare that to the physical auction next to it, $410. But look up above it. That $410 online and $410 physical is on an average vehicle value of $11,000. If I take KAR in the U.S. and if I take – our dealer-to-dealer is U.S. and Canada – the U.S. is selling a car with an average value of $6,500 to $7,000. Canada is a little more than that. I'm getting about the same fees in both.

But on a U.S. vehicle, which is what ACV is, and a U.S. vehicle here that's about a $7,000 car, at physical auction sold online or to a live buyer is about $330 per transaction. If I get ours up to $300 on the TradeRev site, we think that's a sufficient difference to justify the physical auction value proposition of aggregating the vehicles and marshaling them. And we do prepare an independent inspection of the vehicle that is beyond what is done in the online venue. So, that $330 versus $300.

Now, what do I do in gross margin, gross margin dollars? I'm running at about 58% at the physical auction in auction fees, and our target on that site, the TradeRev site, is 75%. I'm

currently offering transportation incentives that is bringing that down in the most recent periods to below 50%. But as we wean markets off the transportation incentives, we can get the gross profit dollars up near that 70% to 75%. We're actually doing that already.

So, we view this as a fair trade. The small amount of difference in the top line revenue I can make up for in gross margin. So, relative to a long-term business performance we do not think there's deterioration of our profitability depending on what channel they use, online versus taking it to physical auction.

As part of this move, we have effective August 1 aligned the dealer-to-dealer sales teams of ADESA and TradeRev to be pursuing one goal, having one compensation structure, and eliminating differentiation between the two. These are just products to help you sell the vehicle. There should not be an economic decision to make here. The seller should pay the same fee. It is the same value proposition. And we have one sales force.

And we need to use our advantage to gain more share, because we think over time the transformation to digital transactions will happen and the value proposition will be around who can aggregate the vehicles, who can provide the services around transportation, get it to the dealer, do it most quickly. It won't be physical versus online. That will be irrelevant to it. So, we need the profitability to be comparable.

It will help us in one way if I can reduce the amount of labor to move vehicles at the physical auction. Even if I'm selling them on TradeRev from a physical auction location, I can improve the total profitability of KAR.

So, that's kind of the outlook. Long term as I look at the marketplace, we see this very much like OPENLANE. OPENLANE, when we acquired it in 2011, was a breakeven business that provides direct, as well as indirect – meaning, transportation and other services. Over $100 million of EBITDA a year now. And we paid $248 million for that business. And so, it's performing at a very high level with very high returns.

We see the TradeRev marketplace actually being bigger than the off-lease space in terms of transactions. We see the economics being quite a bit better on the top line and better on the gross profit or EBITDA dollar per car once it's profitable. So, we think the TradeRev business has the potential to be significantly more profitable even than what we do in the private-label side with OPENLANE.

Chandni Luthra: That brings me to my next question. So, as TradeRev becomes an increasingly bigger part of the business, do you see a diminishing role of physical auctions? Can your real estate strategy evolve as a result of that? And then, as you're disrupting yourself, clearly, how do you define your total addressable market?

Eric Loughmiller: Sure. So, Chandni, you're getting me confused. You asked so many questions I might have forgotten the first one. But when we look at it, first and foremost, it's transformational more than it's disruptive. Dealers have always transacted outside of the physical auction business. And the physical auctions have a very important place in the value proposition of wholesale transactions. Why? We are sitting in a city today that if you have a franchise dealer lot, you have no room to park a car. There's just no room in major metropolitan areas.

And the physical auction offers a place where they can take cars they don't intend to retail, marshal them, have security, have the market know where they can buy those vehicles. The last thing you want to do is send a 10-car hauler in to Manhattan to buy cars one at a time from a dealer who's putting them on one of these sites one car at a time. It's

even worse if you want to go buy them at LaGuardia or JFK and you're going to the rental car lots which have no land. So, there is a value proposition that has very little to do with the auction transaction and has a lot to do with the services we can render from a centralized location in major metropolitan areas.

If I were in a more rural environment, though, I don't really need that. I've got plenty of land, probably plenty of space on the dealer lot. And it's less important there. But that's also, Chandni, as you know – you've covered us for quite a while – that's not where we're investing in our physical auction locations. Our physical auction locations tend to be very large, regionally focused auctions so that we can draw cars and buyers and sellers from areas up to 300 miles away.

When I go to the local auction market, it may not make sense to move a vehicle of low value, like this one, the 2013 Toyota Camry, 134,000 miles. It sold for $8,000. There is nothing you could do to that car to make it worth more than $8,000, because it's got 134,000 miles on it. It's a very high-demand vehicle, because it's a Toyota Camry. But if I ship that car 300 miles, it's not worth $8,500, as compared to an off-lease vehicle which might be low in supply in a market. I have lots of cars with 134,000 miles. They may not all be Toyotas. They might be Nissans. They might be Hondas, Acuras, Lexus, whatever. But these vehicles are basic transportation.

So, we're offering you a transformation. You don't have to move the vehicle. Yet, you can access buyers who might be a few hundred miles away who are willing to pay $8,000 and move the car because they don't have a lot of Toyota Camry's in their marketplace that they could sell to the buyers that are going to pay, in this particular case, probably $10,000 to $11,000 retail for this vehicle if it can be sold as is.

So, we see this – the physical auctions will have a place, but the primary purpose of the physical auction is to marshal the vehicles and provide value-added services, not to run a D2D auction, although we can do that there. It is, though, a place where if you're buying 30 cars you'd want to go, because you can buy 30 cars very efficiently, handle the transaction, you're dealing with a reputable supplier, and you're not buying one car at a time on multiple sites using your mobile applications or online tools. So, you've got to be able to serve the market the way it's asked to be served, including marshaling the vehicles.

So, I see them working together. We actually think the demand for our physical footprint is as high as it's ever been. And yet, 59% – our last quarter, 59% of our transactions were completed to online buyers. But where they're asking for the online purchase to occur is after these value-added services have been rendered, where we've reconditioned the high-value car, we've aggregated – instead of buying one of these, you can buy five cars with 100,000 miles or six or 10 and haul them more efficiently and reduce your transaction costs through those means.

So, that's what we're focused on, and I think there's a place. I think this market will grow. I think, again, all's it can do, though, is on a mobile application link a buyer and a seller. Anything else you need to do requires something other than what the app can provide, and that's where we play in the marketplace. KAR has the capability to provide all of those services, and we think that gives us an advantage in ultimately winning this marketplace.

Chandni Luthra: Then, your total addressable market?

Eric Loughmiller: The total addressable market – it's like these slides were written for you, Chandni. If you look at the bottom of this slide, first, we'll start in the middle: 42 million used car transactions a year, 19 million new car transactions. That's likely creating 30 million – I've got to add up the numbers – 30 million trade-in transactions, which is the basic impetus, a trade-in or a purchased vehicle by the likes of CarMax, Carvana, and their competitors. So, this is creating a wholesale transaction.

So, the addressable market starts with 30 million cars that are going to be retailed out of the 42 million. Twelve million are peer-to-peer; that's consumer-to-consumer. We don't participate in that marketplace at this time. Thirty million, the dealer is going to transact. How does he source – he or she source – the 30 million cars? They get about 14 million in direct trade or purchased from the consumer. So, 14 million, transaction on their lot. They don't need anybody to help them.

They acquire about one million of those – 1.2 million is my number, 1.3 million in total – through the private-label. That's the OPENLANE site that we have very high share of. We sold 1.2 million cars through that technology this year. That's rounded down.

Ten million vehicles they're acquiring at physical auctions. The 10 million is the physical auction industry, not ADESA. Of those, roughly half are dealer-to-dealer and half are commercial consignors selling to dealers, and those would be off-lease cars, repos, rental cars, other fleets, the OEMs, corporate vehicles that they run. At the manufacturers, they have executive cars. All of those vehicles go into that number.

Then there are five million. These are the outliers. Five million transactions where a dealer gets inventory he does not retail but wholesales to another dealership. That's the increase in the addressable market.

So, TradeRev, while it can sell cars that might have previously gone to physical auction in the 10 million, it's really after those transactions – and that five million has been occurring for many, many years. And that's wholesalers that go to the dealer's lot and make an offer to take the cars and redistribute to retailers on their own. And wholesalers, on average, make $500 to $800 per transaction.

It's dealers trading with other dealers directly. If I'm a BMW dealer and I take a Mercedes in trade, I'm not likely to be retailing a used Mercedes. I will probably call the local Mercedes dealer and say, "Hey, I just – number one, I probably want you to know I took one of your customers away. But number two, I've got a used car that you might want on your lot. It's a late-model S-series, whatever it is."

So, these transactions have always occurred. You might trade amongst a group of dealers that you have a relationship with. I happen to live in Chicago. The Chicagoland Dealers Association operates a network for them to exchange trades that's run through their local trade organization. So, there's ways to do that that have never used the formal tools.

And so, what we believe is, hold it. When you do that, you almost always leave money on the table. It's a friendly transaction. There's no price transparency other than, well, here's what the book value says. Oftentimes, the seller of that vehicle was using average book value for the trade-in, not realizing that there's an impact of local market supply and demand that might make that value more or less than that.

So, TradeRev allows you to do the same transaction with the same parties, but expose it to a broader audience to say who will pay the most for this vehicle. It's as simple as that. It's actually not much different than calling a wholesaler who's doing the same thing by

buying the car from you and selling it to someone else, but doing it one car at a time and through a network. This just gives you access, and you can actually access typically a wider area of market that's (inaudible) that.

So, it increases price transparency, and the transaction can be completed much quicker than it would be through the other means. These auctions on TradeRev operate over 40 minutes, start to finish. They're unannounced. If you're a buyer on TradeRev, on your phone you will get an alert because you will have probably set up filters of what types of cars you want to see. You'll get an alert or you'll be just scrolling through what cars are available. And you will bid on those cars and in 40 minutes know were you the high bidder. The dealer who has put it on there may not accept your bid if you're high bidder but it's less than he thinks the value. He will not move further. But if he does, he will indicate on the TradeRev app, okay, this car is being made available for sale. You, the high bidder, and the #2 bidder will have a chance to do final bids and transact on the vehicle. At that point, if you're bidding you're obligated to buy the car. You're bidding on the vehicle.

So, there's a lot of price discovery that goes into this. We do – the sellers on the TradeRev app are franchise dealers. The buyers are typically independent car dealers. The reason we don't typically allow independent dealers is they would list their cars to find out what they're worth during the trade-in process. The franchise dealer, these are cars they don't intend to retail. As you saw, the average wholesale value of $8,000, that's not the traffic on a new car lot, even for their used cars. They're typically selling the off-lease car, the $19,000 CPO'd vehicle that they bought from the captive finance company on the OPENLANE site.

Chandni Luthra: Great. Eric, I'd like to now touch upon the role of technology in your business, especially how does it help bridge the gap between buyers and sellers, especially on TradeRev. And then, are there any standalone monetization opportunities with any data services that you might be providing, say, around value of a particular vehicle or transportation, such as those?

Eric Loughmiller: So, the auction industry 20 years ago was probably known to be, "Hey, it's a game to be played. I can buy cars below their fair value. I know more about the industry." With technology, that's not true anymore. Any one of us probably knows what a car goes for today. You can go on a number of listing sites and find out what the retail value is. No-haggle pricing is the standard, not the exception, anymore; the CarMax model, I call it, of, "This is the price of the vehicle. If you don't pay it, somebody else will." There is still a limited amount of discounting that can occur.

So, I think the technology has played a role in a more informed buyer. And what does that do? When you have a more informed buyer, what does it do to the sellers? It reduces their margins. Right? And that's the big complaint. The dealers make less money, less gross profit per vehicle sold, than they ever did, and that will continue to be the case, because the individual consumer is not willing to pay that dealer more profit to get the vehicle because there is someone else out there with a similar car. We have adequate supply of used car.

The other thing that's changed is the cars are more reliable and will run more miles. If you go back to the late '80s and early '90s, which I can do, Chandni – you may not be able to go back as a driver back then – they had the K-cars, and the K-cars were meant to be obsolete at 90,000 miles. You were lucky if you got 100,000, 110,000 miles on the car.

That's not true. A domestic car today is expected to operate 250,000 to 300,000 miles. It has an enclosed engine compartment, far less deterioration of the underbody. And so, the cars will last a lot longer. And there's a lot less risk today buying a three-year-old car with 40,000 miles on it than there was 20 years ago, 15 years ago, probably even 10 years ago.

And so, as a result, this transparency technology gives you, and the key is data and analytics. We have access to data on our 3.5 million transactions, plus millions of retail transactions where we acquire the data. We can put this all together and help wholesale buyers and sellers understand the real value of the vehicle.

We currently monetize that through market share. We've been doing pilots. We have products like email notifications where we have a handful – it's actually more than a handful; it's almost two handfuls – of captive finance companies that every day for the franchise dealers of their brand receive a recommendation of four vehicles that should fit their retail model today.

What these captives have done is give us access to their DMS. So, we know their inventory levels on their lot. We know their recent sales activity by model, by color, by mileage. We know what inventory is most profitable on their lot. And they have us actually manipulate this data overnight, look at our breadth of inventory because we have all the private-label sites, and tell them, here are four – only four. If you're a dealer, prior to this opportunity you had to scroll through all the industry solutions, thousands of cars, to find the four you want. We take you to that, with links to similar vehicles. And the attach rate on successful sales of that is off the charts. And therefore, we get more share because that's sticky for the captive, where we have a lot of their business.

Monetizing the data outside of market share is more difficult because it's not our data. It's transaction data. Now, our ability to aggregate it, get industry-wide data versus just the data that they would have, is of value. But we have to be careful, because if we monetize it, Chandni, I run the risk of then eliminating an advantage of using my services.

So, right now our focus has been market share. We may be charging – at least one situation we proposed charging on a per-transaction basis, but we are only charging per transaction because they sell all those vehicles on our platform.

We don't want to make all the other platforms in the industry as valuable as ours by having access to the same data tools.

So, it's a tough call for us. So, we're not currently selling the data. We're not a data provider. We do provide access to the data to all of our customers so they can use it to make decisions at other auctions, other auction providers. But we make it a little harder and not as easy as doing business with us, and that's how we look at it.

So, we're excited about it. It's leveled the playing field to many. But again, that's why we operate in duopolies. When you have Cox Automotive and KAR – even in the salvage business you have Insurance Auto Auctions and Copart – the aggregation occurs because you don't need a lot of players. These prices are so well known. The fees per transaction are more efficient when you aggregate into a couple of providers. So, I think we're safe there. And now the question is can we monetize it through market share or perhaps even on my OPENLANE site. Ultimately, charge a little more per transaction because I'm giving their buyers tools that help them make better decisions.

Chandni Luthra: Great. If we could perhaps move across the pond, with your CarsOnTheWeb acquisition. How does that landscape differ versus this market? And then, given CarsOnTheWeb is an asset-light business, talk to us about other potential acquisitions that you might pursue. Would they have more of a physical footprint? Or would they look very similar to CarsOnTheWeb?

Eric Loughmiller: Well, let's start. CarsOnTheWeb, and we own a business in the U.K. that is called ADESA U.K., but it's GRS was the founding. Both are online auction businesses which do not operate on any physical property. We are looking at getting some physical property, either through relationships or buying, but it's only to marshal cars. It is not to run physical auctions. So, you might need a little bit of a footprint.

But over there, what we're doing is we're providing access for sellers to get access to buyers that they don't have in-country. So, we're not attempting to compete with the local auction business, although we could. It's really looking at how can we cross border. There are a number – leasing is more prevalent in Europe than it is in the United States. Over half of all automobile transactions are lease transactions in Europe, and it's an even higher percentage when you go to luxury vehicles.

And so, when those leases are returned, those marketplaces are mature. They're oftentimes trying to move the used inventory away from the local market because they're trying to sell their new cars into that market. And so, we – CarsOnTheWeb has a large percentage of their transactions completed from six western European countries that are very mature into multiple eastern European countries, moving used inventory where they do not have new car sales for many of these brands. These brands go over as used cars.

So, the value proposition is interesting. The fact that it's asset-light is very interesting to us. But we actually looked for a business that had some type of differentiated market expertise, and the cross-border transactions were it. It doesn't help to the U.K. because of right-hand drive versus left-hand drive. So, the U.K. market is unique in and of itself.

As we look at our allocation of capital across the spectrum, we are looking at businesses that actually focus on the wholesale remarketing of vehicles, either online or through other venues. We are probably more interested in asset-light businesses, but that we will tell you we would buy physical auction businesses, not large networks that are fully mature. But in many cases we're doing that to get access to the buyer base, not to the physical footprint so much, although that is often needed.

So, right now our capital deployment is focused on how can we supplement an asset-light nature, including if that means buying smaller networks of physical auction businesses to create the local buyer base.

Chandni Luthra: Would you be willing to lever up if something interesting came up? You talked about your leverage targets earlier.

Eric Loughmiller: Yes – and we've shown this in the past with Brashers, with OPENLANE – we are willing to lever above 3x once we've hit that goal, but typically it's short term. We believe the profits of that business should support bringing that leverage down over a relatively short period of a few quarters. Again, we're a management team that's not afraid of leverage. We were an LBO. We had 6.7x levered and ran a successful business.

That's not where we're headed, but we're comfortable with leverage. But we need to – we really think that in the public markets we want to stay disciplined and target that 3x

leverage, or less, long term and if we go above that have a path to reasonably quickly get back to it. But we would lever up on a short-term basis.

We are right now, though, only interested in profitable businesses that would be accretive in a relatively short period of time to our value. We've done TradeRev. We've done DRIVIN. And we did a little thing called SRATIM, that none of which made money. And we think – we're not a venture capital firm. So, TradeRev is a big bet. Until it's profitable we've internally decided that we're not really interested in businesses that don't contribute profitability and cash flows while we're focused our speculative investment on the TradeRev area.

Chandni Luthra: Eric, talk to us about your long-term EBITDA margin of 25%. Like, what are the right-sizing and cost-saving opportunities that help you get there?

Eric Loughmiller: Well, Chandni, this is the easiest question to describe and probably has elements that are hard to execute, but we're confident we can. So, we're roughly – actually, we were on – we look at this on a net revenue basis – our purchased vehicles we take out of it, which means we were at 21% instead of 20% in the most recent quarters – and getting that to 25%.

But let's assume I can increase my EBITDA margin against – and net revenue, we're only taking out purchased vehicles, which in my financials at the end of the year I plan to give you on the face of the financials the detail so you can see how it's impacting us, because that's kind of a new program. And we aren't taking risk on buying vehicles that we're speculating on value. It's actually a function of how the transaction is executed. And I'm forced to gross up the revenue to the actual auction value of the vehicle, not my fees. And then there's a cost of services, which is the acquisition value. And these are very small margins. But we take that out.

Of the 500-bp improvement, half of that comes from Trade Rev breaking even. And if we could get TradeRev to break even, that would improve our EBITDA margin by 250 basis points. We expect to lose $60 million in operating profit this year, and that's about in the mid-50s in EBITDA. So, that's the number we focus on.

Of the remaining 250 bps of improvement, about 50 bps of it is coming from reducing our corporate overhead. At post-spin, we've been focused on this earlier in the year. We've done some moves that we talked about in our last earnings call. Those will start to show up in our financials. But in addition, we have other areas where we believe. And then we have the ability to recover some of our overhead through our transition services agreement that will lower our cost in the second half. And then as they start moving those services over to IAA, I will eliminate the related cost, because I don't need the people that are working on supporting that organization over the next 18 to 24 months.

That's 300 bps. And the other 200 bps is coming through the use of technology; in particular, something we call virtual lane, where at the physical auction we believe – driven by a safety concern in the industry – we need to move the cars less on auction day. And ironically, while we're focused on safety and making it a safer place, there's actually an opportunity to reduce our labor in delivering the services.

And we have the ability to increase the margins in existing businesses on an EBITDA margin basis. That would account for 200 basis points, most of it coming from reduced labor at the physical auction locations, more efficiency. A little bit of it in that 200 bps actually comes from SG&A at the physical, but all of it is really focused on the ADESA operations.

If we have fewer buyers operating in the lanes because the cars aren't running through, even though the cars are on the lot, it would not be a different experience, other than the cars. We don't take 3,000 pounds of vehicle to drive through 100 people not paying attention, because that's what this is. If you've ever seen an auction tour, you'd understand. It can be very dangerous because especially with mobile devices. People looking at their device with a car with a driver in it thinking that they're pulling in. And listen, there's accidents. And then we have mechanical issues on the vehicles occasionally that are created.

And there's a real focus in the industry on safety. A little over a year – about a year and a half ago, there were five dealers killed in a Massachusetts independent auction and by one car, through a mechanical failure of the vehicle. The owners of that auction have been charged with manslaughter in the state of Massachusetts. I think we have the attention of our industry. If you're not even at the auction and you might be liable for the – this is a serious situation. In October, the National Automobile Auction Association will have their annual meeting in Indianapolis, our home base, and Jim Hallett, our CEO, will be doing the keynote speech. And his six-minute speech is going to focus on safety in the industry.

That safety will allow us to improve the operating model and reduce the labor on sale day, and we think that will help us. And we have a strong drive to make these changes and improve our margins, but also improve the safety. And our customers are behind it. In our Boston auction, in our most recent reporting periods, the last quarter, 30% of our transactions were completed on what we call virtual lanes. And a virtual lane is no different than the physical auction, other than we do not run the car through the people. All the cars are there. You can inspect them. And then we have a screen with an inspection report. The cars are lined up. You can walk outside and touch them, open the doors just like they do, but we do not run the cars.

That is – and we've done that in conjunction with the consignors, who are primarily captive finance companies and banks. But even Group 1 – if you ever go there you'll see us; so, I can say their name – no longer is running the cars in their own lane. And those are low-value trades. They're running a virtual lane. There is no reason to run the cars. And actually, that will provide substantial savings on labor.

And then if you don't have to show up at the auction to get the same information, over time we think we can reduce some of the overhead to support auction day.

Chandni Luthra: Great. I think that's all the time we have. Please join me in thanking Eric for this engaging discussion. Thank you so much.

Eric Loughmiller: Thanks, Chandni, and thanks, everybody.