

KAR Auction Services

KAR Auction Services presentation delivered at the J.P. Morgan Auto Conference on 08/12/2014.

SPEAKER 1: Okay, great. We'll get started with our next presentation then. A company that I really like to cover for from special spot of my heart. Car Auction Services, Eric Lockmiller their Executive Vice President, and Chief Financial Officer. As well as you know, Jonathan Pisner, Treasurer and Vice President of Investor Relations. So, with that I'm going to hand it over to Eric for some prepared remarks, thanks.

SPEAKER 2: Thank you Ryan and it's good to be here with you today. We'll do about 15 maybe 20 minutes of presentation, and hopefully have Q&A at the end. To introduce car auction services, we operate in three primary businesses. And in each of these cases, we operate in effectively a duopoly or oligopoly, but, it's two major players with a fragmented remainder of the market. Our first and largest business segment is Odessa, these are used car auctions. So, we're, we're in the wholesale marketplace, converting used cars from inventory into money, and, and, and I'll get into how we make our money. But we operate in locations in the U.S, Canada, and Mexico. It generates just over $1.1 billion of revenue last year, with $256 million of adjust fee. But with a 22.9% EBIT down margin. I will point out, and I will get to this in a few minutes, we have been in a cyclical decline that is now recovering. And we'll talk about the upside on this. So this is a business with a lot of potential, given the market dynamics were faced with. The second segment, is insurance auto auctions. This is a salvaged auction business, so instead of used cars, these are wrecked cars. And were helping the Insurance companies that's over 80% of our business sell these damaged cars to. Dismantlers, recyclers, and rebuilders of the vehicles. About 30% of the vehicles leave the country. Damaged cars are highly attractive in certain markets, where maybe they don't have to do all of the repairs and could do some of the repairs. Especially in markets, where they may not replace safety equipment. And they're used in other counties. The largest export location is Mexico. And then after that it would go to some South African countries right now, who are actually importing a lot of damaged cars from the United States. And the third leg of our stool is AFC, which is a four plan lending business. And with this business we're assisting used car dealers, having more inventory on the ground by financing the four plan lending. The average term on these loans, is 60 days or less generally, and it's, it's simply that four plan lending. When they sell the car, they must repay the loan. The portfolio is over 1.1, about $1.1 billion right now, of total loans outstanding. And this has been a top performing business for us for many years, though were really pleased to have this as I call it the

third leg of the stool. What market do we operate in, and when you look at this there are 275, or so million vehicles on the road in North America. Of those we have an optimistic number for this year on this chart at 17 million, but 16 to 17 million new car transactions, those are cars that enter the market from the OEMs. And we have about 13 million cars, that go out of registration, they are not kept on the road, annually. Of the 13 million cars, about 3.5 to 4 million, are in the salvage auctions. These are cars, that have had a total loss accident, or low value, don't want it anymore, and they're being sold and really, taken out of the market. The remaining cars, maybe sitting on somebody's. Driveway. They may be in a, in a junk yard, pick 'n pulls. There's different avenues for getting rid of them, but we concentrate and again as I mentioned the Insurance company total loss is the primary focus of that salvage business. Then down below there's 45 million used car transactions a year. And that's where we're focused, of those 13 million are c to c. So if you go onto Craigslist, eBay motors. You may list a car, that's a private transaction from consumer to consumer. And that's in that 13 million transaction, or you put and ad in any of the various online or printed sites that you have. Then there's 32 million transactions, that occur really through dealer networks. In the United States there are about 18,000 franchise dealers. United States and Canada, 18,000 franchise dealers. And there are about 38 to 40,000 independent used car dealers, that aren't affiliated with an OEM. And, amongst that group, there's 32 million transactions year. 20 to 22 million, this is the box on the lower right, are transactions that they were sourced from a trade in, purchasing a car from a consumer, purchasing from another dealer. In, in this part of the market, again, a substantial portion, they're not using our auction. Then there's an eight to 10 million unit volume, where they use our auction industry in order to obtain inventory. And I'll get into what, what the source of those are in a minute. But, but that's basically how they source the cars, that are being sold in the used car marketplace. That $32 million will include used car sales by the franchise dealers, as well as the independent car dealers. How we make money, and from whom do we make this money? In all of our business you think about it, we're dealing with buyers and sellers. At a dozen insurance auto auctions we're gonna collect a fee from the seller of the vehicle, and collect a fee from the buyer of the vehicle. Who is selling the cars in Odessa? The sellers are going to be. Finance companies, banks, freight lease operators, a number of businesses that end up with ownership of the car, but they don't retail the vehicle. As well as about half the industry, a little more than half right now are dealers who have aged inventory, or inventory that's off their brand where they're going to use the auction. We, to distribute it to a different portion of the dealer network, so we call, we call it dealer consignment. The buyers of those vehicles are going to be franchise dealers, and independent used car dealers, so it's very basic. In addition to the fee for selling the car, and buying the fee at the Odessa locations, we have a number of ancillary services and related services around the processes of moving used cars. And we make money for anything that we do, on behalf of the buyer, the seller. So, we charge fees for everything. We, we typically do not take risk on the

principle value of the vehicle. It's a consignment business, and a service business. So we're not out there betting on the values of vehicles, whatever the vehicle sells for. Determines maybe the fee structure, but that value is not a risk to, to car auction services. On the insurance auto auction side, the primary sellers of the vehicles are the insurance companies. Over 80% of the volume come from total loss vehicles processed by the major insurance companies in the U.S. and Canada. Then the buyers of those vehicles again, are the, are, are going to be. The dismantlers, rebuilders, and resellers, recyclers, and especially the international buyers. In fact, we ship cars to over 100 countries around the World annually. And about 30% of the volume ends up in a foreign land. And again, it's a hard number to measure, because some of them are exported by brokers. But, we get affidavits and try to track how many. There, the revenue sources are going to be the self feed from the consigner, and the buy feed from the buyer. There's very little in ancillary services because the car's damaged, and there's absolutely no reason to dress it up. It's, it's typically a damaged, or a very low value vehicle. And then the AFC. Actually makes, their, their, their money on the loan transaction itself. AFC is focused on loaning money to the independent used car dealer, but their also doing loans to the buyers at the salvage auctions, they handle some RV's. A, a few recreational vehicles, a few motor sports and things like that. But, predominately it's, it's used cars as a majority of their market. Averaging, ironically, only $160 per loan transaction, because these are very short term loans. That portfolio of $1.1 billion returning about seven times a year. So it's a very quick term, it's not a consumer loan oriented portfolio. One of the major themes of the investment in core option services right now, is that we've gone through a very difficult time, a recession in the auto industry, which resulted in a kind of a change in the supply of vehicles. And we are now entering, are in the beginning of and in the onset of a cyclical recovery. These are the industry's data. How many used cars are sold through the auction environment on an annual basis? And you can see we went through a number of years ten plus years with fairly steady volumes between $9 and $10 million, basically around $9.5 million per year. And then until we started the decline, which began, what, 2009 was $9 million, 2008, that dropped as a function of a lot of new car transactions, so fewer trades. And, and again some disruption even in the off lease industry and other places where they were not using the auction market, due to the shortage of vehicles but they were looking to put on their lot. And you can see where we are now. We are in the beginning stages, the first couple of years of a recovery that, it looks like it has some legs behind it to go several more years. With the SAR increasing, lease penetration rates increasing. All of that will fuel transactions, some of which will end up in our marketplace, in the used car auction business. So it's a very exciting time, much more exciting than 2010, 11 and 12 were in this business. But again, even in those periods you'll see our financial. Numbers at the end of this presentation when John goes through them. We were able to perform, perform very well. And actually, maintaining the dot the bottom. And then grow it, during this period of declining volumes in the largest part of our business. But we have a very

strong, sustainable business that performs in really any economic climate. Even at, at extremes we, we can perform at a level that's pretty impressive. It is a business that generates significant cash flow. We have a component within this, that beginning in 2011, we acquired a company called Oaken Lane that gave us a significant market share, we handled 32, or 33 of the 37 main brands of vehicles, handling their private label, close sales. This is how they distribute primarily off lease vehicles, into their franchise dealership network. So when a car is returned from a lease, at the end of lease you'll get an inspection. You'll return it to a grounding dealer, that grounding dealer does not own the car. That grounding dealer typically will have the right to buy that car, at the contract residual value. Whatever value they gave you. Roughly three years prior that they said, this is what it'll cost you to buy that car, at the end of this lease. Many consumers pass on that option, not putting in the capital, return the car in, they probably lease another one. But in this case, the grounding deal are, in exchange for his servicing that car, has the opportunity to buy that car at residual value. When he passes on that, the consumer has passed. The dealer has passed. It then goes into a private label closed sales. Where the OEMs will offer it, to their broad dealership network. And they can buy that without competition, from other brand names. Other franchise dealers, or independent used car dealers. After that, it goes into an open sale online, and the car is still sitting at the grounding dealer. Generally speaking it's five to seven days, to offer this online without moving the car. After that five to seven day period, the car moves to a physical auction. Which is Odessa or one of our major competitors. This is the funnel, so this is the process. If it's not captured above the funnel by the consumer or the grounding dealer, it goes online only, private label. This has low revenue per vehicle. And high, very high margin, because it's a technology based business, and each incremental car, there's essentially very little incremental cost to sell the car. After that, two to three days it will move into the open sale, and then it moves into the physical auction. The great advantage to the physical auction is our ability to provide ancillary services. But my average revenue per vehicle in the second quarter, for the online only portion, the top two elements of this follow me, was only $99 per transaction, very high margin. At the physical auction in the second quarter the average revenue per vehicle was $680. So you can see why, we would like cars to get through the funnel. The primary difference is for those 33 brands we have 100% market share in the private label closed and the open sale. When you get down to the bottom of physical auction. We have 25% market share in the total industry, and within the commercial we think it's a little greater than that. So think in, in terms of directional we get one out of three cars. If it gets through this funnel, even though we're the private label and the open sale, two out of three will end up at our competitor's. Either Mannheim the largest competitor, or a large independent that's handling the cars for them. So there's a real advantage for us to try to capture more share at the top of the funnel, however the mix has caused our average revenue per vehicle to remain lower, and as a cyclical recovery that I talked about is coming we are as a management team expecting. More cars to make it to physical

auction if the franchise dealers are, their inventory levels are fairly full to their, their inventory management targets, and they'll buy fewer of these. And as, and we've gone through this with a number of investors, in 2015 there will be 700,000 more lease terminations than there, there will be in 2014. That's on a base in 2000, and this is in the United States, we're gonna keep Canada out of it, which is a little laggard behind this. On a basic 3.2 million lease terminations were expected roughly this year, that will go to 3.9, and then 4.4 million in 2016. So as this, and by the way. The only years we've 3.2 million or less, in lease termination using a three year average would have been 2014, 2013, and 2012. We will get back to levels in the high 3s, and low 4s, that were sustained for most of. The first decade of the, of the millennium. So it's a very interesting, we're getting back to normal, and the opportunity is tremendous if I can get to that $680 per vehicle sold. It would, it would be, I'd be remiss not to mention insurance auto auctions which has been an outstanding performer having outstanding growth this year. It's a stable performer. It probably doesn't experience the cyclical nature of the used car business. It's more weather oriented, and that, the bottom line is the more we drive the more we wreck. And so there's a steady flow of vehicles. Huge demand. Companies like LKQ that are dismantling and redistributing after market recycled parts. Ironically, when the collision repair industry. The value of proposition that we afford them by having all these insurance vehicles is the lowest priced and highest margin component for everybody in the supply chain of repairing a car is the aftermarket recycled part. It's very rare that you can have the lowest price and the highest margin. Because when you manufacture, it costs more and everybody makes less money. Including the collision repair shop, the distributer of the parts, and the manufacturer of the parts. So it's very interesting. There's a lot of demand for these parts, and you can see in the bottom right-hand corner. As, as this has become really the trend in the industry using aftermarket recycled parts is a way to lower claims costs for the insurance companies. And one of the few opportunities for them to lower that cost. AFC is also a very strong business that after the cyclical decline. By the way we took. Some heavy hits in that business for a very short period of time. At the end of 2008 and early 2009, not surprisingly the four plan lending business was a tough place to be. However, we, we took the losses at that time. Reduced the portfolio. And in March of 2008 the portfolio was about $960 million, and in March of 2009 the portfolio was under $400 million. What we did is we wanted to create the capacity of the market recovered, that we could then grow that business, and we did that. And its been growing since 2009 at a very high growth rate. It's starting to level off more in line with industry volumes, but we were capturing market share, because we were the player in the industry that's sufficient. Capital available to grow as the, these independent used car dealers started to roll their floor, floor plan and expand their markets, and even new entrants came into the market. So, with that I'm going to turn it over to John, so I can get a drink of water, and he'll take care of the financials. But I appreciate your time today, and again look forward to your questions.

SPEAKER 3: Thanks Eric, I'm gonna go through the financials pretty quickly, so there's lots of time for q and a. So if we look over the last five years you can see that despite an industry decline of approximately 300,000 units we grew our revenue by about 25%. We expanded our gross profit percentage, over 200 bits, to 44.5%, excluding the impact of super storm Sandy, and grew adjusted by over 25%. And adjusted EPS by almost 60%. As we discussed on last week's earnings call, our second quarter results were strong. We posted an 8% increase in revenue, a 10% increase in adjusted EBITDA, and a 24% increase in adjusted earnings per share. Volumes were up for all three businesses, and with our largest business ADESA, posting a 6% increase in volumes. Just a couple of quick comments on our capital structure. Net leverage at the end of the second quarter was just under three times, and by way of reference our term loan b one bears interest at l plus 250 bits. There's no libel or floor to that. Our term loan B2, bears interest at L plus 275, and there's a 75 bit floor. And by way of reference, we also have a two year cap, at $1.2 billion of debt, and that expires next August.

SPEAKER 3: So lastly, this slide really pictorially represents, our greatest investment attribute. Which is having a business model, that throws off a lot of free cash flow. And we're gonna use that free cash flow, to invest in long term strategic growth opportunities. And our recently announced Trade Rev equity investment is a great example of that. And return capital to shareholders. And by way of reference we currently return $140 million, to shareholders annually. These will be our annual dividend. And with that Eric and I would now be happy to answer any questions you may have.

QUESTION: Great, thank you Jonathan. We'll just ask, one or two to get us started. First relates to capital allocation. Which drives a lot of the, the inbound, calls that I get from this name. firstly, relative to you know? It's capital allocation, generally. All of your freak out flow was historically allocated toward you know, financial deleverage, until you initiated your divided. now you pay out a, a fair amount already of your free cash flow to your share holders. But in regards to the remainder of it, how do you evaluate between strategic initiatives and we just saw in return, for example that, that's one opportunity small one, relative to for example share repurchases. Which I know you have some increased flexibility. Relative to your, your credit agreements as of late.

ANSWER: Okay Ryan, well, good question and one I'm handling on a regular basis over the last couple of days in New York. You know, the capital allocation issue is, is very straightforward for us. We generate a lot of cash. We have a target leverage ratio of three times or less, and my senior leverage is currently at 2.62 times. So, so, when I look at that, we stated in our first quarter conference call, that we would, we do not intend to repay any debt, other than mandatory principle repayments in the current debt structure. In other words, we need to utilize our cash, to create shareholder value. At, and, we're in a low interest rate environment. At this point in time, we are focused on prioritizing strategic growth opportunities from investments. An example is

trade rev. Are there things out there that now is the right time to pursue, or if not, at what time would they be the right time to pursue. Qualify and disqualify opportunities. At the same time, we're comfortable that over the next several years we'll, we'll generate significant free cash flow. So at this stage, we think, we think having a dividend that generally will be a premium to the average dividend yield for S&P 500 dividend-paying stocks is important. It draws attention to our cash flows. Then on top of that, looking at the other alternatives, we've created the flexibility in the credit agreement, which did not exist prior to march to have all options available to us. And at this stage, we're just evaluating what is the most appropriate use of that capital over the long period. We do take a long term views, not a short term view in terms of that capital allocation philosophy. So, I don't have much more to say today, many have expected for us more granularity on specifics and, and, at this point in time, we're really in the process of making sure we understand all the priorities. So, that we don't react to something in the short term, that eliminates an opportunity in the longer term; that would really be more creative and more value creation for our shareholder base. Then a quick follow-up to that then I see those questions in the back of the room. But I I spent strategic initiative in our guide near our term of productivity potentially. Can we talk about what opportunities are available in strategic initiatives? There is obviously geographical expansion you know, outside of the United States. Orc in Canada which you've mentioned way back in the F1, I think. And then also there's potential you know, peripheral and market expansion, I guess. You know the other things are options besides, besides a little bit right now. Relative to, to have I think and in, in, in our views and what not. can, can you talk, kind of talk about, you know, what, what we can expect potentially within particular initiatives. What's available out there? But we are a public company, so it makes it difficult to talk about things that we haven't announced. But what we've given guidance on is really where we're focused is looking at technology and expanding into new markets. And we say expanding into new markets, it would include adjacent space. And adjacent space would be, is there something that utilizes our expertise and our platform. Or something being sold through a different customer base, or is it our current customer base? Is there something that we can distribute to that customer base on our existing platform? Couple of examples, we, we actually have a heavy equipment business, we bought in Canada. It's very small. We wanted to see is there, is there a synergy, between car auction facilities, which some of them are fairly large. And the ability to sell something. The difference is that's a market that's dominated by one global player, Richard Brothers. So, we're not trying to compete with them, but is there a place where there's a pi, piece of the market. And I will tell you we're, we constantly look at something like that. That's a transaction we completed. AFC completed preferred warranty. That was an acquisition where we were looking at the Independent Used-Cars Dealers in order to compete with the CarMaxs of the world. And, and the franchise dealers had become attaching service contracts to used car sales in many cases. Well, how do you distribute that? Well, we have relationships with 12,000 active dealers. We have a

financial commitment and we have a, I mean listen, when you do for plan lending your in contact with them weekly. I mean you have to stay close to the collateral. Accordingly, it's an opportunity, and what we did is we bought preferred warranty because it was a relatively small business. I didn't have to pay for what they've developed as a distribution network, they were in a handful of states where they concentrated. And now we can take that product and roll it out. On a national basis in the US. Well, again, relatively small transaction, others would be bigger. I mean, and again, we don't want to get in to sizing, but these are things that we've looked at. I can give you the examples. Technology, trade rep is another one, we just did the investment in trade rep. And again, we made an investment of $30 million. A substantial amount of that is required to stay in business to support the roll out, into new geographies, including, the United States. The reason, we're doing that is, that they've never had a lot money, it was a technology entrepreneur adventure. Give them the capital because, this could be an opportunity where first to market has an advantage and you, you can't go into a limited number of cities and let people copy it ,in the cities you haven't reached. So, we really wanna accelerate their process of rolling out, because it's an exciting product that's out on the marketplace handling fresh trades. Ironically when I say fresh trade, when you are sitting there negotiating with the salesman, what's the right value of your trade in, they can be auctioning your car while you're there. They don't own it yet, they can be auctioning your car to find out what it would get, how many people are interested in it. And then when they close the transaction they say the car is now avai-, . it's a really exciting project. I'm probably giving you more than my CEO would like to give you, because our competition may listen to this on the webcast. But my only point is it's in Canada. It's been rolled out in two major metropol, so everybody kinda knows what it, what it does. It's an exciting opportunity. Is there cannibalization when you do that? Perhaps. But not much, because in the markets they're operating in, we operate the largest physical auction in those markets. And our dealer consignment business has actually grown faster than theirs. It, so it's, it's a different part of the market. Could there be some cannibalization? Yes, but it, I showed you that chart. It gives us access to 20 to 22 million transaction a year, of which half we think are transactions that the dealer exchanges a car with another dealer in some manner. So, half of that is our addressable market. It's a whole new market. So, those are the adjacent spaces we're talking about, right? And then technology again is the kicker. Whether it be enhancements to the operations we have today, or new product offerings. And the reason we like that is we've built a business that has a lot of land. We want to know, how can we expand in an asset-like fashion and that would apply to any geography, you know? The U.S. has been rolled up. Canada has been rolled up. It, it's an industry where us and our largest competitor rolled up independent auction. When we go and look at new geographies the roll up's over. How can we get in there? There's less land commitment, less asset commitment and more service orient commitment, because the markets have changed in the last 50 years, when this roll up began when Manheim starting to acquire

auctions or their predecessors. So, it's a very exciting time for us, we think there are. Are a lot opportunities in the near term. That's why we're really studying the priorities. We've had a situation where there's been a lot of M&A activity talked about, but not a lot that deals close in the type of things we do. And it's because the buyers and sellers can't get together on price, because the seller generally want credit for the value the capital markets is giving us and low interest rates. Well guess what, the monetization of the ownership of those sellers is becoming a priority and we're starting to see values become more reasonable. Which would mean typically we would expect immediate or near immediate accretion to our shareholders. We aren't going to buy a business that thinks their value is based upon our multiple in the marketplace, cuz we have a more sophisticated business in many places. Then what they're doing. An exception, I'll go back with open lane, where it was very strategic, buying it in a downturn. We don't see more like that in, in, at this point in time where, where there's a, there's a kind of an industry changing technology that we really need to own. So I think that sums it up, gives you a little color. Not a lot of specifics. And we'll keep you posted as things get further along in the process.

QUESTION: So it's very helpful. Was there a question on that? Yeah?

ANSWER: I think he was cheering for the dividend.

QUESTION: Oh!

ANSWER: I was not, but I'm for it. Maybe it'll lower the overhead.

QUESTION: And I didn't pay for that advertising. Of the publicly traded dealer groups of announced a couple different initiatives over time that may or may not have an impact on your business. And one would be their drive to transfer more used vehicles within their own system. So wholesaling fewer, fewer vehicles, as much as possible, because they see a profit potential in that. And then two is the their efforts towards having sort of used car superstores. And that would then you know, relate to a Carmax for example. Wondering how those two, if either of those efforts have a potential to have an impact of your business.

ANSWER: Of course they do, because you're exchanging the car between dealers. But the potential impact for us, any time there's movement of parts between dealerships, it's positive for our business and our industry and the reason is there's a lot of things we do that enhance that childless and look at the fee structure. It's, it's fairly nominal. What I, I mean, I'm getting $680 of the physical option, when they move a car from one dealer to another, and that's when they do work. And if you, if you really cut it down to the online only in the open, ignore the franchise dealers, it's $300. And guess what? It's at fair value. You, you create price discovery even amongst in, the, the individual locations within a national retail group because I think, you also know all of their general managers are compensated on local store performance. And so it's very

important that there's an accurate price when they decide to move inventory around, or you're gonna get general managers saying, how do I run this business? And then the announcement of the super stores again, it's fantastic for us. It draws attention to people that are focused on selling and marketing retail used cars to the consumer. And they have to get their inventory somewhere. And we absolutely know that there's no inventory management system that can generate the same quality of trade-in when you sell a retail used car. If you're selling five to seven year old used cars because your franchise dealer's gonna sell one to three, one to four, right? What are you getting in trade on a five to seven year old car? Probably a 10 to 12 year old car. Well, if that's not your market, the 10 to 12 year old car becomes a wholesale transaction that we get an opportunity to be involved in. So we see increased activity, increased focus on used cars as a positive. Yet there's an element of rise to it, and they do more on their own. Are they trying to circumvent the auction process? Maybe so. At the end of the day though, there's such a high value proposition to what we do, relative to the total cost of the transaction when you get to the consumer that we think we have a great selling proposition to participate in the inventory management in both scenarios that you get laid out there. There's an opportunity, again in some of them. So I think it's positive. Just to add that we actually assist in the dealer to dealer movement. We've put out a lease with the prestige group, which I think is here in the Northeast, in terms of helping them trade inventory among their various stores. So that's another opportunity.

QUESTION: Say, when clients aren't calling me about capital allocation, they're calling me about the funnel. They're calling me about percentage of off lease vehicles, sold online only. And I think this would be a good opportunity to answer, you know, what their concern is. Their concern is that basically, certain people in the industry, not necessarily you guys, but back in 2009 through kind of 11 type period. You know, we were undergoing a couple of secular structural shifts relative to what I guess you would call rental channel diversion and percentage of just whole cars generally being transacted online only. And some people were slow to recognize that that was structural in nature, in part because there's so much stuff going on cyclically at the time it was hard to tell. So to what degree do you think there is a chance that this really does suggest something very structural and not related to structure and behavior on the part of franchise dealers? Now, and if it were structural is it more about the way that vehicles are sold or bought? And if it's about bought, then presumably, you would find non-franchise dealers or franchise dealer is not of the same type of car that's being bought by online. So that would basically be boosting the online-only open market. So, it is that a possibility, number one. And if it is a possibility, it's a structural shift. Is it gonna go more to the online-only open, which would be a lot more powerful?

ANSWER: Well, it, it, it, we announce on a call we're going to get out of the predicting business on where all this stuff is going to happen. But the bottom line is 2009, 10 and 11 were not normal,

and what you describe as structural change was survival. You had to get the cart, there was no inventory, there were no late model cars coming in, there were no trades for new cars at the same level we experienced, so you naturally, probably in many cases, were will to take more risk on an online transaction. Here's what's interesting, even through today where we've gotten more comfortable, the online-only venue is 90% off lease cars. And the reason being, the process at end of lease is conducive to an online sale. There is an end of lease inspection report, typically performed by a third party, that any, any consumer will dispute, when they say that there's damage that doesn't exist. And that is done as part of the end of lease process. That becomes a key input, into an online-only venue because you need an after, after a condition report. How many of you would buy a car online from Joe's Wreck Shop? You wouldn't do it. You, you go and you buy it from a captive finance company that you trust and had a process that evaluated that car for reasons other than to convince you to buy it. They had to settle up on the deposit, on the security deposit. Second, the car is lifted and predominantly folded based upon the average revenue per vehicle in this funnel, everybody knows they're being sold in a private label close. Who is most likely to trust that captive finance company? Franchise dealer that is dependent upon them for their lifeblood to all the inventory on their new car lot as well as their used car lot. And it's a transaction where if you get that car, and it's not as you thought it was, don't you think you probably have a pretty good conversation with someone who's depending on you to borrow for their entire inventory of new cars? So I think it's a transaction that naturally is easier. It gets tougher when you go to open because now I'm gonna deal with people who don't have that same relationship with the captive finance company. And then I'm gonna get to the physical auction where I'm gonna deal with people who want to touch the car because obviously, they're trying to manage inventory, and they want to touch it not because they don't trust the car cuz they gotta know can, I get that on the front line of my used car lot by this weekend because Saturday is the number one day of sales in the used car industry. And everything is about I can't miss a Saturday cuz if I miss a Saturday, I have to carry that inventory for another week before I get enough traffic to sell it. They sell cars every day, but they sell a high percentage of them on Saturday, and that's throughout the country. So when we look at it structurally, we have sold 260,000 cars online-only in the first 6 months of 2014. When we, we've given these directional numbers. In 2009, the last peak, the last peak for off lease vehicles and online-only using the Odessa business plus open lane, which was independent at the time. The industry sold between 500 and 550,000 cars online. It's not hard to calculate 260 times 2 is 520. And it's in the range of the same level. The difference is, it's a high percentage of what's coming back right now, because there's been a shortage of those vehicles. Structural change, yeah. We think they're more comfortable. Ironically, the growth in online buying is greater at the physical auction through our live block and other products than it has been in this space. It's really interesting. The online buyer has gotten more comfortable, but they still want the reconditioning of the car. Why do cars not sell in the funnel? One of the

reasons is the condition report discloses something that needs to be repaired before you retail it, and the auction won't do that for them in advance of the sale. So there's a value proposition they're waiting on. It isn't that I don't wanna buy, I don't buy every car. They don't buy every car, because they're only gonna buy the car that they think they can retail very quickly when they buy it online. Or it's a franchise dealer who has an inventory management system that says, you know, you need more three year old Ford Fusions because we just sold five of them last weekend. And that's the car that's in demand today. Let's get more Ford Fusions. And how do you get them? Private label close, off lease for many within months. The other concept that is missed here is very few of these cars are transported over 350 miles. So I've told you about the 17, 18,000 franchised dealers. How many of them are within 350 miles and operate in your brand. It's a very small market when you get down to where they transact. So what we need is more volume, and I think the structural change will be less significant than what we're fighting with. There's been a disruption in the supply chain that is fixing itself, but we're not promising it to you. Here's the good news. We built our business that wherever they sell the car, we can make money. We were up 6% in revenue at Odessa, 8% in with a heavier concentration than online. If we can manage that cost structure at the physical auction, we have the market share with these five label sites. We do not want to incent them to go to any part of this funnel. Wherever they sell the car, we want us to be part of the transaction. At the same time, we're not seeing evidence, Ryan. Structurally, you'd start to see more rental cars, you'd start to see more fleets. It's just not happening. And it's because of the process is conducive to an online sale.

QUESTION: Very helpful, caller. Thanks, thanks Eric and, and John.

ANSWER: Sure. Thank you. Thank you.

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