

KAR Auction Services, Inc.

Form 10-Q

November 04, 2016

Use these links to rapidly review the document

[Table of Contents](#)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 001-34568

KAR Auction Services, Inc.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization) 20-8744739 (I.R.S. Employer Identification No.)

13085 Hamilton Crossing Boulevard

Carmel, Indiana 46032

(Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: (800) 923-3725

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Non-accelerated filer

Large accelerated filer Accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 31, 2016, 138,162,233 shares of the registrant's common stock, par value \$0.01 per share, were outstanding.

Table of Contents

KAR Auction Services, Inc.
Table of Contents

	Page
<u>PART I—FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements (Unaudited)</u>	
<u>Consolidated Statements of Income</u>	3
<u>Consolidated Statements of Comprehensive Income</u>	4
<u>Consolidated Balance Sheets</u>	5
<u>Consolidated Statements of Stockholders' Equity</u>	7
<u>Consolidated Statements of Cash Flows</u>	8
<u>Notes to Consolidated Financial Statements</u>	9
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	42
<u>Item 4. Controls and Procedures</u>	43
<u>PART II—OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	44
<u>Item 1A. Risk Factors</u>	44
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	45
<u>Item 6. Exhibits</u>	45
<u>Signatures</u>	46
<u>Exhibit Index</u>	47

Table of Contents

PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

KAR Auction Services, Inc.

Consolidated Statements of Income

(In millions, except per share data)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Operating revenues				
ADESA Auction Services	\$441.6	\$351.4	\$1,277.2	\$1,024.4
IAA Salvage Services	261.0	246.2	795.4	732.8
AFC	71.2	69.1	218.0	200.2
Total operating revenues	773.8	666.7	2,290.6	1,957.4
Operating expenses				
Cost of services (exclusive of depreciation and amortization)	443.7	378.1	1,293.3	1,096.7
Selling, general and administrative	146.3	128.5	434.3	373.5
Depreciation and amortization	60.5	54.1	175.9	156.8
Total operating expenses	650.5	560.7	1,903.5	1,627.0
Operating profit	123.3	106.0	387.1	330.4
Interest expense	36.3	24.4	100.8	67.2
Other (income) expense, net	0.8	(0.3)	(0.8)	(2.1)
Loss on extinguishment of debt	—	—	4.0	—
Income before income taxes	86.2	81.9	283.1	265.3
Income taxes	31.8	29.6	106.2	99.0
Net income	\$54.4	\$52.3	\$176.9	\$166.3
Net income per share				
Basic	\$0.39	\$0.37	\$1.29	\$1.18
Diluted	\$0.39	\$0.37	\$1.27	\$1.16
Dividends declared per common share	\$0.29	\$0.27	\$0.87	\$0.81

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Consolidated Statements of Comprehensive Income

(In millions)

(Unaudited)

	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net income	\$54.4	\$52.3	\$176.9	\$166.3
Other comprehensive loss				
Foreign currency translation loss	(4.7)	(14.2)	(0.4)	(29.4)
Comprehensive income	\$49.7	\$38.1	\$176.5	\$136.9

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
 Consolidated Balance Sheets
 (In millions)
 (Unaudited)

	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	\$ 323.1	\$ 155.0
Restricted cash	15.4	16.2
Trade receivables, net of allowances of \$9.6 and \$6.6	681.8	511.9
Finance receivables, net of allowances \$9.8 and \$9.0	1,775.6	1,632.0
Other current assets	138.4	131.0
Total current assets	2,934.3	2,446.1
Other assets		
Goodwill	2,008.3	1,795.9
Customer relationships, net of accumulated amortization of \$687.2 and \$619.3	461.8	417.7
Other intangible assets, net of accumulated amortization of \$287.1 and \$258.1	317.5	310.8
Other assets	36.8	34.1
Total other assets	2,824.4	2,558.5
Property and equipment, net of accumulated depreciation of \$632.1 and \$569.6	827.7	766.9
Total assets	\$ 6,586.4	\$ 5,771.5

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
 Consolidated Balance Sheets
 (In millions, except share and per share data)
 (Unaudited)

	September 30, 2016	December 31, 2015
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 700.3	\$ 608.4
Accrued employee benefits and compensation expenses	93.1	90.9
Accrued interest	1.2	0.8
Other accrued expenses	145.5	128.4
Income taxes payable	3.9	5.3
Dividends payable	40.1	37.2
Obligations collateralized by finance receivables	1,275.1	1,189.0
Current maturities of long-term debt	24.7	153.9
Total current liabilities	2,283.9	2,213.9
Non-current liabilities		
Long-term debt	2,371.8	1,711.2
Deferred income tax liabilities	289.4	300.8
Other liabilities	163.5	159.5
Total non-current liabilities	2,824.7	2,171.5
Commitments and contingencies (Note 8)		
Stockholders' equity		
Preferred stock, \$0.01 par value:		
Authorized shares: 100,000,000		
Issued shares: none		
Common stock, \$0.01 par value:		
Authorized shares: 400,000,000		
Issued and outstanding shares:		
September 30, 2016: 138,125,402		
December 31, 2015: 137,795,296	1.4	1.4
Additional paid-in capital	1,442.8	1,407.6
Retained earnings	74.2	17.3
Accumulated other comprehensive loss	(40.6	) (40.2
Total stockholders' equity	1,477.8	1,386.1
Total liabilities and stockholders' equity	\$ 6,586.4	\$ 5,771.5

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.
 Consolidated Statements of Stockholders' Equity
 (In millions)
 (Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance at December 31, 2015	137.8	\$ 1.4	\$ 1,407.6	\$ 17.3	\$ (40.2)	\$ 1,386.1
Net income				176.9		176.9
Other comprehensive loss					(0.4)	(0.4)
Issuance of common stock under stock plans	1.1		13.8			13.8
Stock-based compensation expense			14.2			14.2
Excess tax benefit from stock-based compensation			7.1			7.1
Repurchase and retirement of common stock	(0.8)		—			—
Dividends earned under stock plans			0.1	(0.1)		—
Cash dividends declared to stockholders (\$0.87 per share)				(119.9)		(119.9)
Balance at September 30, 2016	138.1	\$ 1.4	\$ 1,442.8	\$ 74.2	\$ (40.6)	\$ 1,477.8

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Nine Months Ended		2015	
	September 30,			
	2016			
Operating activities				
Net income	\$	176.9	\$	166.3
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	175.9		156.8	
Provision for credit losses	23.5		12.4	
Deferred income taxes	(11.8)	)	(14.4))
Amortization of debt issuance costs	6.5		5.3	
Stock-based compensation	14.2		9.0	
Excess tax benefit from stock-based compensation	(7.1)	)	(6.5))
Loss on disposal of fixed assets	0.1		1.3	
Loss on extinguishment of debt	4.0		—	
Other non-cash, net	6.4		2.8	
Changes in operating assets and liabilities, net of acquisitions:				
Trade receivables and other assets	(178.5)	)	(164.0))
Accounts payable and accrued expenses	73.7		146.4	
Net cash provided by operating activities	283.8		315.4	
Investing activities				
Net increase in finance receivables held for investment	(158.7)	)	(177.1))
Acquisition of businesses, net of cash acquired	(354.5)	)	(115.2))
Purchases of property, equipment and computer software	(118.5)	)	(92.3))
Proceeds from the sale of property and equipment	—		0.1	
Decrease in restricted cash	0.8		2.0	
	(630.9)	)	(382.5))

Net cash used by investing activities			
Financing activities			
Net increase in book overdrafts	29.6		18.1
Net (decrease) increase in borrowings from lines of credit	(140.0	)	130.5
Net increase in obligations collateralized by finance receivables	78.8		268.2
Proceeds from long-term debt	1,336.5		—
Payments for debt issuance costs/amendments	(19.5	)	(10.9
Payments on long-term debt	(654.4	)	(16.9
Payments on capital leases	(18.8	)	(14.9
Payments of contingent consideration and deferred acquisition costs	(3.6	)	(1.2
Initial net investment for interest rate caps	—		(2.2
Issuance of common stock under stock plans	13.8		18.8
Excess tax benefit from stock-based compensation	7.1		6.5
Repurchase and retirement of common stock	—		(227.6
Dividends paid to stockholders	(117.0	)	(114.8
Net cash provided by financing activities	512.5		53.6
Effect of exchange rate changes on cash	2.7		(14.1
Net increase (decrease) in cash and cash equivalents	168.1		(27.6
Cash and cash equivalents at beginning of period	155.0		152.9
Cash and cash equivalents at end of period	\$	323.1	\$
Cash paid for interest	\$	91.0	\$
Cash paid for taxes, net of refunds	\$	99.9	\$

See accompanying notes to consolidated financial statements

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements

September 30, 2016 (Unaudited)

Note 1—Basis of Presentation and Nature of Operations

Defined Terms

Unless otherwise indicated or unless the context otherwise requires, the following terms used herein shall have the following meanings:

• "we," "us," "our" and "the Company" refer, collectively, to KAR Auction Services, Inc. and all of its subsidiaries;

• "ADESA" or "ADESA Auctions" refer, collectively, to ADESA, Inc., a wholly-owned subsidiary of KAR Auction Services, and ADESA, Inc.'s subsidiaries, including OPENLANE, Inc. (together with OPENLANE, Inc.'s subsidiaries, "OPENLANE") and ADESA Remarketing Limited (formerly known as GRS Remarketing Limited ("GRS"));

• "AFC" refers, collectively, to Automotive Finance Corporation, a wholly-owned subsidiary of ADESA, and Automotive Finance Corporation's subsidiaries and other related entities, including PWI Holdings, Inc.;

• "Credit Agreement" refers to the Amended and Restated Credit Agreement, dated March 11, 2014, among KAR Auction Services, as the borrower, the several banks and other financial institutions or entities from time to time parties thereto and the administrative agent, as amended on March 9, 2016;

• "Credit Facility" refers to the three-year senior secured term loan B-1 facility ("Term Loan B-1"), the seven-year senior secured term loan B-2 facility ("Term Loan B-2"), the seven-year senior secured term loan B-3 facility ("Term Loan B-3"), the \$300 million, five-year senior secured revolving credit facility (the "revolving credit facility") and the \$250 million, five-year senior secured revolving credit facility (the "old revolving credit facility"), the terms of which are set forth in the Credit Agreement. Term Loan B-1 and the old revolving credit facility were extinguished in March 2016 with proceeds received from Term Loan B-3;

• "IAA" refers, collectively, to Insurance Auto Auctions, Inc., a wholly-owned subsidiary of KAR Auction Services, and Insurance Auto Auctions, Inc.'s subsidiaries and other related entities, including HBC Vehicle Services ("HBC"); and

• "KAR Auction Services" refers to KAR Auction Services, Inc. and not to its subsidiaries.

Business and Nature of Operations

As of September 30, 2016, we have a North American network of 76 ADESA whole car auction sites and 173 IAA salvage vehicle auction sites; in addition, we offer online auctions for both whole car and salvage vehicles. ADESA also includes ADESA Remarketing Limited (formerly known as GRS), an online whole car vehicle remarketing business in the United Kingdom. IAA also includes HBC Vehicle Services, which operates from 10 locations in the United Kingdom. Our auctions facilitate the sale of used and salvage vehicles through physical, online or hybrid auctions, which permit Internet buyers to participate in physical auctions. ADESA and IAA are leading, national providers of wholesale and salvage vehicle auctions and related vehicle remarketing services for the automotive industry in North America. ADESA's online service offerings include customized private label solutions powered with software developed by its wholly-owned subsidiary, OPENLANE, that allow our institutional consignors (automobile manufacturers, captive finance companies and other institutions) to offer vehicles via the Internet prior to arrival at the physical auction. Remarketing services include a variety of activities designed to transfer used and salvage vehicles between sellers and buyers throughout the vehicle life cycle. ADESA and IAA facilitate the exchange of these vehicles through an auction marketplace, which aligns sellers and buyers. As an agent for customers, the Company generally does not take title to or ownership of vehicles sold at the auctions. Generally, fees are earned from the seller and buyer on each successful auction transaction in addition to fees earned for ancillary services.

ADESA has the second largest used vehicle auction network in North America, based upon the number of used vehicles sold through auctions annually, and also provides services such as inbound and outbound transportation logistics, reconditioning, vehicle inspection and certification, titling, administrative and collateral recovery services. ADESA is able to serve the diverse and multi-faceted needs of its customers through the wide range of services offered.

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2016 (Unaudited)

IAA is one of the leading providers of salvage vehicle auctions and related services. The salvage auctions facilitate the remarketing of damaged vehicles that are designated as total losses by insurance companies, recovered stolen vehicles for which an insurance settlement with the vehicle owner has already been made, purchased vehicles and older model vehicles donated to charity or sold by dealers in salvage auctions. The salvage auction business specializes in providing services such as inbound transportation logistics, inspections, evaluations, salvage recovery services, titling and settlement administrative services.

AFC is a leading provider of floorplan financing to independent used vehicle dealers and this financing is provided through 124 locations throughout the United States and Canada as of September 30, 2016. Floorplan financing supports independent used vehicle dealers in North America who purchase vehicles at ADESA, IAA, other used vehicle and salvage auctions and non-auction purchases. In addition to floorplan financing, AFC also provides independent used vehicle dealers with other related services and products, such as vehicle service contracts.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. GAAP for annual financial statements. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole. In the opinion of management, the consolidated financial statements reflect all adjustments, generally consisting of normal recurring accruals, necessary for a fair statement of our results of operations, cash flows and financial position for the periods presented. These consolidated financial statements and condensed notes to consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission on February 18, 2016. The 2015 year-end consolidated balance sheet data included in this Form 10-Q was derived from the audited financial statements referenced above and does not include all disclosures required by U.S. GAAP for annual financial statements.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates.

Unamortized Debt Issuance Costs

Debt issuance costs reflect the expenditures incurred in conjunction with term loan debt, the revolving credit facility and the U.S. and Canadian receivables purchase agreements. The debt issuance costs are being amortized to interest expense using the effective interest method or the straight-line method, as applicable, over the lives of the related debt issues.

We adopted Accounting Standards Update ("ASU") 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs, in the first quarter of 2016. The update required debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. The new guidance represents a change in accounting principle and required retrospective application. As shown in the table below, we have reclassified unamortized debt issuance costs previously reported as of December 31, 2015 (in millions):

	Originally Reported	Reclassified	As Adjusted
Unamortized debt issuance costs	\$ 20.3	\$ (20.3)	\$ —
Obligations collateralized by finance receivables	1,201.2	(12.2)	1,189.0

Long-term debt 1,719.3 (8.1) 1,711.2

10

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2016 (Unaudited)

New Accounting Standards

In August 2016, the Financial Accounting Standards Board ("FASB") issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which provides guidance on the statement of cash flows presentation of certain transactions where diversity in practice exists. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-15 will have on the consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The update changes the methodology for measuring credit losses on financial instruments and the timing of when such losses are recorded. The new guidance is effective for annual periods beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted beginning in annual periods beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact the adoption of ASU 2016-13 will have on the consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The update changes how companies account for certain aspects of share-based payment awards to employees, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. The new guidance is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-09 will have on the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which replaces existing lease guidance. The ASU is intended to provide enhanced transparency and comparability by requiring lessees to record right-of-use assets and corresponding lease liabilities on the balance sheet, with an exception for leases that meet the definition of a short-term lease. The new guidance will continue to classify leases as either finance or operating, with classification affecting the pattern of expense recognition in the statement of income. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted and the ASU is required to be applied with a modified retrospective approach to each prior reporting period presented with various optional practical expedients. The Company is currently evaluating the impact the adoption of ASU 2016-02 will have on the consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which superseded the revenue recognition requirements in Accounting Standards Codification ("ASC") 605, Revenue Recognition. The new guidance provides clarification on the recognition of revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosures to help financial statement users better understand the nature, amount, timing and uncertainty of revenue that is recognized. In August 2015, the FASB issued ASU 2015-14 Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 by one year. In accordance with the agreed upon delay, the new guidance is effective for the first annual reporting period and interim periods beginning after December 15, 2017, and will require either retrospective application to each prior reporting period presented or retrospective application with the cumulative effect of initially applying the standard recognized at the date of adoption. The Company is currently

evaluating the impact the adoption of ASU 2014-09 will have on the consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

Note 2—Acquisitions

In February 2016, ADESA signed a definitive agreement to acquire auctions owned by the Brasher family. In April 2016, ADESA completed the acquisition of Brasher's eight auctions, which strengthens ADESA's western U.S. footprint. In 2015, Brasher's had revenue of approximately \$140 million. We entered into operating lease obligations related to various facilities through 2036. Initial annual lease payments for the various facilities are approximately \$5 million per year.

In March 2016, ADESA signed a definitive agreement to acquire Sanford Auto Dealers Exchange ("SADE"). In May 2016, ADESA completed the acquisition of SADE, which expands ADESA's geographic footprint in central Florida.

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2016 (Unaudited)

In June 2016, the Company acquired GRS, a subsidiary of Greenhous Group Limited. GRS is an established online vehicle remarketing business in the U.K. The acquisition complements the Company's wide range of vehicle remarketing services and provides the opportunity to offer our full range of services in the U.K.

Certain of the purchase agreements included contingent payments related to vehicle volumes subsequent to the purchase date. The purchased assets included land, buildings, accounts receivable, operating equipment, customer relationships, tradenames, software, inventory and other intangible assets. Financial results for each acquisition have been included in our consolidated financial statements from the date of acquisition.

The aggregate purchase price for the businesses acquired in the first nine months of 2016, net of cash acquired, was approximately \$355.8 million, which included estimated contingent payments with a fair value of \$1.3 million. The maximum amount of undiscounted contingent payments related to these acquisitions could approximate \$1.5 million. The purchase price for the acquired businesses was allocated to acquired assets and liabilities based upon fair values, including \$113.9 million to intangible assets, representing the fair value of acquired customer relationships of \$106.8 million, software of \$5.1 million, tradenames of \$1.8 million and non-competes of \$0.2 million, which are being amortized over their expected useful lives. The purchase accounting associated with these acquisitions is preliminary, subject to determination of working capital adjustments and a final valuation of intangibles. The Company does not expect adjustments to the purchase accounting will be material. The acquisitions resulted in aggregate goodwill of \$218.3 million. The goodwill is recorded in the ADESA Auctions and AFC reportable segments. The financial impact of these acquisitions, including pro forma financial results, was immaterial to the Company's consolidated results for the nine months ended September 30, 2016.

Note 3—Stock and Stock-Based Compensation Plans

The KAR Auction Services, Inc. 2009 Omnibus Stock and Incentive Plan ("Omnibus Plan") is intended to provide equity or cash-based awards to our employees. Our stock-based compensation expense includes expense associated with KAR Auction Services, Inc. performance-based restricted stock units ("PRSUs"), service-based restricted stock units ("RSUs") and service options. We have classified the KAR Auction Services, Inc. PRSUs, RSUs and service options as equity awards.

The total income tax benefit recognized in the consolidated statement of income for PRSUs, RSUs and service options was approximately \$1.7 million and \$1.2 million for the three months ended September 30, 2016 and 2015, respectively, and \$5.4 million and \$3.4 million for the nine months ended September 30, 2016 and 2015, respectively. The following table summarizes our stock-based compensation expense by type of award (in millions):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
PRSUs	\$2.5	\$1.7	\$8.2	\$4.6
RSUs	1.4	0.7	4.4	1.8
Service options	0.5	0.8	1.6	2.6
Total stock-based compensation expense	\$4.4	\$3.2	\$14.2	\$9.0

PRSUs and RSUs

In the first nine months of 2016, we granted a target amount of approximately 0.3 million PRSUs to certain executive officers and management of the Company. The PRSUs vest if and to the extent that the Company's three-year operating adjusted earnings per share attains certain specified goals. In addition, approximately 0.3 million RSUs were

granted to certain executive officers and management of the Company. The RSUs are contingent upon continued employment and vest in three equal annual installments. The weighted average grant date fair value of the PRSUs and the RSUs was \$34.81 per share and \$34.84 per share, respectively, which was determined using the closing price of the Company's common stock on the dates of grant. The PRSU and RSU grants were made pursuant to the Company's Policy on Granting Equity Awards.

12

Table of Contents

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2016 (Unaudited)

Share Repurchase Program

In October 2014, the board of directors authorized a repurchase of up to \$300 million of the Company's outstanding common stock, par value \$0.01 per share, through October 28, 2016. Repurchases may be made in the open market or through privately negotiated transactions, in accordance with applicable securities laws and regulations, including pursuant to repurchase plans designed to comply with Rule 10b5-1 of the Securities Exchange Act of 1934, as amended. The timing and amount of any repurchases is subject to market and other conditions. For the year ended December 31, 2015, we repurchased and retired a total of 744,900 shares of common stock in the open market at a weighted average price of \$37.04 per share.

In August 2015, as part of the authorized program to repurchase common stock noted above, the Company entered into an accelerated share repurchase agreement under which it paid \$200 million for an initial delivery of approximately 4.6 million shares of its common stock. The initial delivery of shares represented 90% of the shares anticipated to be repurchased based on current market prices at that time. The initial delivery of shares also resulted in an immediate reduction in the number of shares used to calculate the weighted average common shares outstanding for basic and diluted net income per share. The Company settled the accelerated share repurchase agreement in January 2016 and received approximately 0.8 million additional shares of its common stock based on an adjusted volume weighted average price of its stock over the period. In total, 5,413,274 shares were repurchased under the accelerated share repurchase agreement at an average repurchase price of \$36.95 per share.

Note 4—Net Income Per Share

The following table sets forth the computation of net income per share (in millions except per share amounts):