KAR Auction Services, Inc. (KAR)

Baird Facts

Please refer to Appendix - Important Disclosures and Analyst Certification.

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<tbody>
<tr>
<td>52WK H-L ($) :</td>
<td>29 - 9</td>
<td>Price Target ($) :</td>
<td>18</td>
<td>Q1</td>
<td>0.20A</td>
<td>0.09E</td>
<td></td>
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<tr>
<td>Market Cap (mil):</td>
<td>1,587</td>
<td>L-Term Rev. Gr Rate Est:</td>
<td>5%</td>
<td>Q2</td>
<td>0.30A</td>
<td>(0.16)E</td>
<td></td>
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<tr>
<td>Shares Out (mil):</td>
<td>130.0</td>
<td>L-Term EPS Gr Rate Est:</td>
<td>10%</td>
<td>Q3</td>
<td>0.35A</td>
<td>0.16E</td>
<td></td>
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<tr>
<td>Float (mil):</td>
<td>127.8</td>
<td>Debt/Cap:</td>
<td>54.6%</td>
<td>Q4</td>
<td>0.19A</td>
<td>0.16E</td>
<td></td>
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<tr>
<td>Avg. Daily Vol (mil):</td>
<td>2.58</td>
<td>ROE:</td>
<td>8.3%</td>
<td>Total</td>
<td>1.04A</td>
<td>0.25E</td>
<td>1.00E</td>
</tr>
<tr>
<td>Dividend ($) :</td>
<td>0.00</td>
<td></td>
<td></td>
<td>FY P/E</td>
<td>11.7x</td>
<td>48.8x</td>
<td>12.2x</td>
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<tr>
<td>Yield (%):</td>
<td>0.0</td>
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<tr>
<th>Headquartered: Carmel, IN</th>
<th>IPO/Founded 2009/1982</th>
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<tr>
<td>Management</td>
<td>James Hallett, Don Gottwald, Eric Loughmiller, Mike Eliason</td>
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</table>

Company Description

KAR Auction Services is a leading remarketer of used vehicles, offering a portfolio of solutions to sellers and buyers in North America and Europe. Through its subsidiaries, KAR remarkets over 3.5 million vehicles annually in online-only, physical auction, and dealer-to-dealer remarketing channels – earning fees for transactions on consigned inventory and revenue for ancillary services like inspection reports, transportation, and reconditioning. The company also provides credit to dealers seeking short term floorplan financing through its AFC subsidiary.

Revenue Profile

ADESA (Whole Car). ADESA conducts whole car auctions, earning fees from buyers and sellers totaling ~$600 per car. The business sources vehicles from dealers, fleet operators, rental companies and captive finance companies, and auctions them mainly to used car dealers. Revenue is a function of volume and price. The acquisition of OPENLANE, the leading internet-based auctioneer of used cars, adds to the ADESA platform.

Automotive Finance Corporation (Dealer Financing). AFC provides wholesale financing to car dealers. It earns ~$150 per loan transaction.
KAR Auction Services, Inc.
May 20, 2020

Competition
KAR Auction Services is the No. 2 player in the ~11 million vehicle whole car market and one of two leading players in the 5 million-plus vehicle salvage market. Its largest competitor is Manheim (over 40% of whole car volume), along with smaller, digital only auctions (ACV Auctions, EBlock). Sellers are seeking the highest return on vehicles consigned at the lowest cost. Buyers are seeking the widest selection of vehicles at the lowest cost to acquire.

Quick Summary
When the crisis passes, KAR will emerge a different company. For now, the pace of change is staggering. KAR transitioned from a traditional live auction (with cars physically passing through an auction block with a live auctioneer) to fully simulcast auctions in just seven days, adding thousands of new online bidders. To the extent the pandemic accelerated change that was inevitable, it may help. We still believe the wholesale remarketing process will require many of the physical services KAR provides (storage, reconditioning, transportation), but the sale process will likely stay digital.
Investment Thesis

Valuation. Our $18 price target is based on ~8x NTM adjusted EBITDA one year from now, a discount to KAR’s pre-spin historical trading average of ~10x given the headwinds and uncertainty surrounding the impact of COVID-19. Shares of KAR currently trade at 8x our NTM EBITDA estimate.

KAR Auction Services is the parent to several businesses serving the whole car remarketing industry, including ADESA, AFC, Openlane, and TradeRev. Collectively, these businesses remarket over 3.5 million used vehicles, primarily in the United States, Canada, the United Kingdom, and now Europe. These auction platforms earn fees to match buyers and sellers through multiple remarketing channels. Often, these transactions create opportunities for other KAR subsidiaries to provide ancillary services – including inspection reports (AutoVin), reconditioning services, a transportation marketplace (CarsArrive), and short-term dealer loans (AFC) – which together enhance the stickiness of the platform. Additionally, KAR subsidiaries like DRIVIN and STRATIM leverage data generated within the KAR ecosystem to help dealers and fleet operators manage their businesses with superior information. Investment considerations include:

- Strong number two in whole car auction oligopoly
- Dominant remarketer of off-lease vehicles as off-lease volume nears plateau
- Growing dealer-to-dealer remarketing platform (TradeRev) requiring significant investment
- Leading floorplan lender
- Growing RPU fueled by lower-margin ancillary services that drive stickiness

Risks & Caveats

We see a wider range of potential outcomes for KAR following the IAA spinoff due to cyclical dynamics and industry disruption. At its core, KAR operates a deeply entrenched remarketing franchise – but faces multiple risks including:

- Cyclical headwinds tied to demand for used vehicles
- A slowdown in the off-lease cycle
- Material disruption of the traditional auction process
- Significant expenditures to launch TradeRev, which remains unprofitable
- Challenges building a profitable remarketing platform in Europe
- Higher losses or default on AFC auto loans
- Elevated financial leverage
- Competitive dynamics
Appendix - Important Disclosures and Analyst Certification

Approved on 20 May 2020 09:30EDT/ Published on 20 May 2020 09:35EDT.

Covered Companies Mentioned
All stock prices below are the 5/19/2020 closing price.

Copart, Inc. (CPRT - $83.93 - Outperform)
(See recent research reports for more information)

Rating and Price Target History for: KAR Auction Services, Inc. (KAR) as of 05-19-2020

Rating and Price Target History for: Copart, Inc. (CPRT) as of 05-19-2020

1 Robert W. Baird & Co. Incorporated makes a market in the securities of KAR and CPRT.

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