INSURANCE AUTO AUCTIONS, INC
Form 424B3
November 04, 2010
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Filed Pursuant to Rule 424(b)(3)

Registration No. 333-166047

PROSPECTUS SUPPLEMENT NO. 3

(to Prospectus dated April 22, 2010)

KAR AUCTION SERVICES, INC.

$150,000,000 Floating Rate Senior Notes Due 2014

$450,000,000 8 3/4% Senior Notes Due 2014

$199,408,000 10% Senior Subordinated Notes Due 2015

Attached hereto and incorporated by reference herein is our Quarterly Report on Form 10-Q for the quarterly period ended September 30, 2010, filed with the Securities and Exchange Commission on November 4, 2010. You should read this Prospectus Supplement No. 3 in connection with the prospectus, dated April 22, 2010, including the prospectus supplements dated May 7, 2010 and August 4, 2010. This Prospectus Supplement No. 3 is qualified by reference to the prospectus, including the prospectus supplements dated May 7, 2010 and August 4, 2010, except to the extent that the information in this Prospectus Supplement No. 3 supersedes the information contained therein.

SEE RISK FACTORS BEGINNING ON PAGE 6 OF THE PROSPECTUS AND UNDER ITEM 1A IN THE ANNUAL REPORT ON FORM 10-K FOR THE YEAR ENDED DECEMBER 31, 2009 FOR A DISCUSSION OF CERTAIN RISKS YOU SHOULD CONSIDER BEFORE INVESTING IN THE NOTES.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these notes or passed upon the adequacy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus has been prepared for and may be used by Goldman, Sachs & Co. in connection with offers and sales of the notes related to market-making transactions in the notes effected from time to time. Goldman, Sachs & Co. may act as principal or agent in these transactions. Such sales will be made at prevailing market prices at the time of sale, at prices related thereto or at negotiated prices. We will not receive any proceeds from such sales.

GOLDMAN, SACHS & CO.

November 4, 2010

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2010

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	**20-8744739**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**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 x 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.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x 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 x

As of October 31, 2010, 135,342,344 shares of the registrant s common stock, par value $0.01 per share, were outstanding.

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KAR Auction Services, Inc.

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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 September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Operating revenues				
ADESA Auction Services	**$ 267.4**	$ 270.8	**$ 821.1**	$ 838.6
IAAI Salvage Services	**142.3**	135.5	**458.4**	412.5
AFC	**35.6**	23.8	**94.2**	60.6
Total operating revenues	**445.3**	430.1	**1,373.7**	1,311.7
Operating expenses				
Cost of services (exclusive of depreciation and amortization)	**241.6**	239.6	**749.3**	755.1
Selling, general and administrative	**90.4**	101.4	**276.2**	274.3
Depreciation and amortization	**42.2**	41.6	**127.3**	129.9
Total operating expenses	**374.2**	382.6	**1,152.8**	1,159.3
Operating profit	**71.1**	47.5	**220.9**	152.4
Interest expense	**35.5**	39.3	**106.3**	132.8
Other (income) expense, net	**(1.1)**	(4.8)	**(2.7)**	(9.3)
Loss on extinguishment of debt			**25.3**	
Income before income taxes	**36.7**	13.0	**92.0**	28.9
Income taxes	**11.1**	4.4	**29.7**	11.0
Net income	**$ 25.6**	$ 8.6	**$ 62.3**	$ 17.9
Net income per share basic and diluted	**$ 0.19**	$ 0.08	**$ 0.46**	$ 0.17

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions)

	September 30, 2010 (unaudited)	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	**$ 379.8**	$ 363.9
Restricted cash	**6.1**	9.3
Trade receivables, net of allowances of $6.5 and $6.9	**356.0**	250.4
Finance receivables, net of allowances	**120.4**	150.3
Finance receivables securitized, net of allowances	**584.4**	
Retained interests in finance receivables sold		89.8
Deferred income tax assets	**42.6**	37.3
Other current assets	**41.0**	40.9
Total current assets	**1,530.3**	941.9
Other assets		
Goodwill	**1,528.5**	1,528.1
Customer relationships, net of accumulated amortization of $235.5 and $182.7	**703.5**	753.3
Other intangible assets, net of accumulated amortization of $87.7 and $62.9	**262.9**	266.8
Unamortized debt issuance costs	**45.0**	61.6
Other assets	**12.2**	16.4
Total other assets	**2,552.1**	2,626.2
Property and equipment, net of accumulated depreciation of $282.5 and $233.4	**666.7**	683.2
Total assets	**$ 4,749.1**	$ 4,251.3

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Balance Sheets

(In millions, except share and per share data)

	September 30, 2010 (unaudited)	December 31, 2009
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	**$ 434.1**	$ 262.7
Accrued employee benefits and compensation expenses	**49.6**	56.4
Accrued interest	**26.1**	14.8
Other accrued expenses	**82.7**	80.2
Income taxes payable		2.7
Obligations collateralized by finance receivables	**479.0**	
Current maturities of long-term debt		225.6
Total current liabilities	**1,071.5**	642.4
Non-current liabilities		
Long-term debt	**2,019.0**	2,047.3
Deferred income tax liabilities	**327.8**	328.2
Other liabilities	**112.0**	91.9
Total non-current liabilities	**2,458.8**	2,467.4
Commitments and contingencies (Note 12)		
Stockholders equity		
Preferred stock, $0.01 par value:		
Authorized shares: 100,000,000		
Issued shares: none		
Common stock, $0.01 par value:		
Authorized shares: 400,000,000		
Issued and outstanding shares:		
September 30, 2010: 135,339,008		
December 31, 2009: 134,509,710	**1.4**	1.4
Additional paid-in capital	**1,373.5**	1,355.2
Retained deficit	**(172.2)**	(234.5)
Accumulated other comprehensive income	**16.1**	19.4
Total stockholders equity	**1,218.8**	1,141.5
Total liabilities and stockholders equity	**$ 4,749.1**	$ 4,251.3

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Statement of Stockholders Equity

(In millions)

(Unaudited)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Deficit	Accumulated Other Comprehensive Income	Total
Balance at December 31, 2009	134.5	$ 1.4	$ 1,355.2	($ 234.5)	$ 19.4	$ 1,141.5
Comprehensive income:						
Net income				62.3		62.3
Other comprehensive income (loss), net of tax:						
Unrealized loss on interest rate derivatives					(7.0)	(7.0)
Foreign currency translation					3.7	3.7
Comprehensive income				62.3	(3.3)	59.0
Issuance of common stock under stock plans	0.8		3.7			3.7
Stock-based compensation expense			12.4			12.4
Excess tax benefits from stock-based compensation			2.2			2.2
Balance at September 30, 2010	**135.3**	**$ 1.4**	**$ 1,373.5**	**($ 172.2)**	**$ 16.1**	**$ 1,218.8**

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Consolidated Statements of Cash Flows

(In millions)

(Unaudited)

	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Operating activities		
Net income	**$ 62.3**	$ 17.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	**127.3**	129.9
Provision for credit losses	**8.3**	2.3
Deferred income taxes	**2.7**	(8.5)
Amortization of debt issuance costs	**10.3**	10.0
Stock-based compensation	**12.4**	15.7
Loss on disposal of fixed assets	**0.2**	1.1
Loss on extinguishment of debt	**25.3**	
Other non-cash, net	**9.8**	8.3
Changes in operating assets and liabilities, net of acquisitions:		
Finance receivables held for sale	**50.2**	23.0
Retained interests in finance receivables sold	**89.8**	(34.5)
Trade receivables and other assets	**(109.4)**	(33.0)
Accounts payable and accrued expenses	**128.8**	106.9
Net cash provided by operating activities	**418.0**	239.1
Investing activities		
Net increase in finance receivables held for investment	**(609.4)**	(2.8)
Acquisition of businesses and related contingent payments, net of cash acquired	**(2.7)**	(4.1)
Purchases of property, equipment and computer software	**(41.9)**	(40.8)
Purchases of other intangibles	**(0.5)**	
Proceeds from the sale of property and equipment	**2.0**	0.3
Decrease in restricted cash	**3.2**	7.1
Net cash used by investing activities	**(649.3)**	(40.3)
Financing activities		
Net increase in book overdrafts	**37.3**	30.8
Net decrease in borrowings from lines of credit		(4.5)
Payments for debt issuance costs		(0.3)
Net increase in obligations collateralized by finance receivables	**479.0**	
Payments on long-term debt	**(28.3)**	
Payment for early extinguishment of debt	**(243.6)**	
Payments on capital leases	**(3.4)**	(2.2)
Initial net investment for interest rate cap		(1.3)
Issuance of common stock under stock plans	**3.7**	
Excess tax benefits from stock-based compensation	**2.2**	
Net cash provided by financing activities	**246.9**	22.5

Effect of exchange rate changes on cash	**0.3**	1.1
Net increase in cash and cash equivalents	**15.9**	222.4
Cash and cash equivalents at beginning of period	**363.9**	158.4
Cash and cash equivalents at end of period	**$ 379.8**	$ 380.8

See accompanying Notes to Consolidated Financial Statements

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements

September 30, 2010 (Unaudited)

Note 1 Basis of Presentation and Nature of Operations

Defined Terms

Unless otherwise indicated, the following terms used herein shall have the following meanings:

- we, us, our, KAR Auction Services and the Company refer, collectively, to KAR Auction Services, Inc. (formerly known as KAR Holdings, Inc.) and all of its subsidiaries unless the context otherwise requires;

- ADESA refers, collectively, to ADESA, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries;

- AFC refers, collectively, to Automotive Finance Corporation, a wholly owned subsidiary of ADESA and its subsidiaries;

- Axle LLC refers to Axle Holdings II, LLC, which is owned by affiliates of certain of the Equity Sponsors (Kelso & Company and Parthenon), certain members or former members of IAAI management and certain co-investors in connection with the acquisition of IAAI in 2005. Axle LLC is the former ultimate parent company of IAAI and is a holder of common equity interests in KAR LLC;

- Credit Agreement refers to the Credit Agreement, dated April 20, 2007, among KAR Auction Services, as the borrower, KAR LLC, as guarantor, the several lenders from time to time parties thereto and the administrative agent, the joint bookrunners, the co-documentation agents, the syndication agent and the joint lead arrangers named therein, as amended on June 10, 2009, October 23, 2009 and from time to time;

- Equity Sponsors refers, collectively, to Kelso Investment Associates VII, L.P., GS Capital Partners VI, L.P., ValueAct Capital Master Fund, L.P. and Parthenon Investors II, L.P., which collectively own through their respective affiliates a majority of the equity of KAR Auction Services;

- IAAI refers, collectively, to Insurance Auto Auctions, Inc., a wholly owned subsidiary of KAR Auction Services, and its subsidiaries; and

- KAR LLC refers to KAR Holdings II, LLC, which is owned by affiliates of the Equity Sponsors and management of the Company.

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, or 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 generally accepted accounting principles 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 necessary, generally consisting of normal recurring accruals, for a fair statement of our financial results for the periods presented. In preparing the accompanying financial statements, management has evaluated subsequent events through the date the financial statements were issued. The preparation of financial statements in conformity with generally accepted accounting principles 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. A listing of our critical accounting estimates is described in the   Critical Accounting Estimates

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

section of Management s Discussion and Analysis of Financial Condition and Results of Operations in this Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2009, filed with the Securities and Exchange Commission (SEC) on February 25, 2010 (File No: 001-34568), which includes audited financial statements.

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 for the year ended December 31, 2009 included in our Annual Report on Form 10-K for the year ended December 31, 2009. The 2009 year-end consolidated balance sheet data included in this Form 10-Q was derived from the audited financial statements referenced above, but does not include all disclosures required by U.S. GAAP.

Nature of operations

As of November 4, 2010, we have a network of 70 ADESA whole car auctions and 158 IAAI salvage vehicle auctions which facilitate the sale of used and salvage vehicles through physical, online or hybrid auctions, and which permit Internet buyers to participate in physical auctions. ADESA Auctions and IAAI are leading, national providers of wholesale and salvage vehicle auctions and related vehicle redistribution services for the automotive industry in North America. Redistribution services include a variety of activities designed to transfer used and salvage vehicles between sellers and buyers throughout the vehicle life cycle. ADESA Auctions and IAAI 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 to substantially all 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 logistics, reconditioning, vehicle inspection and certification, titling, administrative and salvage recovery services. ADESA is able to serve the diverse and multi-faceted needs of its customers through the wide range of services offered at its facilities.

IAAI is one of the two largest providers of salvage vehicle auctions and related services in North America. The salvage auctions facilitate the redistribution 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 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 and outbound logistics, inspections, evaluations, titling and settlement administrative services.

AFC is a leading provider of floorplan financing to independent used vehicle dealers and this financing is provided through 88 loan production offices located throughout North America. Floorplan financing supports independent used vehicle dealers in North America who purchase vehicles at ADESA, IAAI, independent auctions and auctions affiliated with other auction networks.

Note 2 Accounting Change as a Result of the Adoption of Accounting Standards Update 2009-16

In December 2009, the Financial Accounting Standards Board (FASB) issued new guidance (Accounting Standards Update 2009-16) on the accounting for transfers of financial assets. The new guidance, which is now a part of ASC 860, *Transfers and Servicing*, eliminates the concept of a qualifying special-purpose entity, creates

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

more stringent conditions for reporting a transfer of a portion of a financial asset as a sale, clarifies other sale-accounting criteria and changes the initial measurement of a transferor s interest in transferred financial assets. The new guidance is effective on a prospective basis for annual periods beginning after November 15, 2009. This new guidance requires inclusion of loans sold to a bank conduit facility as well as the related obligation originated after December 31, 2009, in our financial statements. We adopted the guidance on January 1, 2010. This resulted in an increase in assets and related obligations in 2010. Obligations collateralized by finance receivables were $479.0 million at September 30, 2010. In addition, the new guidance eliminated securitization income accounting and resulted in the recording of fee and interest income and interest expense for the finance receivable transactions under the revolving sale agreement. The elimination of securitization income accounting resulted in a reduction of pre-tax income of approximately $2.8 million in the first quarter of 2010. See Note 6 for additional information.

Note 3 New Accounting Standards

In July 2010, the FASB issued new guidance (Accounting Standards Update 2010-20) on the credit quality of financing receivables and the allowance for credit losses. The new guidance, which amends ASC 310, *Receivables*, requires further disaggregated disclosures that improve financial statement users understanding of (1) the nature of an entity s credit risk associated with its financing receivables and (2) the entity s assessment of that risk in estimating its allowance for credit losses as well as changes in the allowance and the reasons for those changes. The new guidance is generally effective for interim and annual reporting periods ending on or after December 15, 2010; however, certain aspects of the guidance pertaining to activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after December 15, 2010. As ASU 2010-20 only applies to financial statement disclosures, it will not have a material impact on the consolidated financial statements.

In February 2010, the FASB issued new guidance (Accounting Standards Update 2010-06) on fair value measurements. The new guidance, which is now a part of ASC 820, *Fair Value Measurements and Disclosures,* requires disclosure of details of significant transfers in and out of Level 1 and Level 2 measurements and reasons for the transfers. In addition, a gross presentation of activity within the Level 3 roll forward, presenting separately information about purchases, sales, issuances and settlements is required. The new guidance is effective for the first interim or annual reporting period beginning after December 15, 2009, with the exception for the gross presentation of the Level 3 roll forward, which is required for annual reporting periods beginning after December 15, 2010 and for interim reporting periods within those years. The adoption of the new guidance did not have a material impact on the consolidated financial statements.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Note 4 Stock-Based Compensation Plans

We adopted the KAR Auction Services, Inc. 2009 Omnibus and Stock Incentive Plan (Omnibus Plan) in December 2009. The Omnibus Plan is intended to provide equity or cash based awards to our employees. On March 1, 2010, we granted approximately 0.3 million service options and 0.7 million exit options with an exercise price of $13.46 per share under the Omnibus Plan. In addition, approximately 0.1 million service options have been granted since March 1, 2010 with exercise prices ranging from $12.10 to $14.86. The options have a ten year life. The service options vest in four equal annual installments, commencing on the first anniversary of the grant date. The exit options vest as follows:

Amount Vested	Conditions to Vesting
25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $20.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $25.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $30.00*
An additional 25% of exit options shall vest and become exercisable if	(i) the fair market value of Company common stock exceeds $35.00*

* Additional conditions to vesting: (ii) the price of the Company s common stock on the last trading day of a 90 consecutive trading day period must be greater than or equal to 85% of $20.00, $25.00, $30.00 or $35.00, respectively; and (iii) the option holder is a director, officer, employee, consultant or agent of the Company or any of its subsidiaries on the date on which the conditions set forth in (i) and (ii) above are satisfied.

For purposes of determining the conditions to vesting, the fair market value of any share of Company common stock, on any date of determination, shall be the average for 90 consecutive trading days prior to such date of determination of the last sales price for a share of Company common stock on the principal securities exchange on which the Company common stock is then listed.

Our stock-based compensation expense includes expenses associated with KAR Auction Services, Inc. service and exit option awards, KAR LLC operating unit awards and Axle LLC operating unit awards. We have classified the KAR LLC and Axle LLC operating units as liability awards. We have classified the KAR Auction Services, Inc. service and exit options as equity awards. The main difference between a liability-classified award and an equity-classified award is that liability-classified awards are remeasured each reporting period at fair value.

The compensation cost that was charged against income for all stock-based compensation plans was $5.1 million and $12.4 million for the three and nine months ended September 30, 2010, respectively, and the total income tax benefit recognized in the Consolidated Statement of Income for options was approximately $1.6 million and $4.8 million for the three and nine months ended September 30, 2010, respectively. The compensation cost that was charged against income for all stock-based compensation plans was $14.8 million and $15.7 million for the three and nine months ended September 30, 2009, respectively, and the total income tax benefit recognized in the Consolidated Statement of Income for options was approximately $2.4 million and $2.7 million for the three and nine months ended September 30, 2009, respectively. We did not capitalize any stock-based compensation cost in the nine months ended September 30, 2010 or 2009.

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

KAR Auction Services, Inc. Employee Stock Purchase Plan

Our board of directors and stockholders adopted the KAR Auction Services, Inc. Employee Stock Purchase Plan (ESPP) in December 2009 and the ESPP was implemented in the second quarter of 2010. A maximum of 1,000,000 shares of our common stock have been reserved for issuance under the ESPP and at September 30, 2010, 964,720 shares remain available for purchase under the ESPP. The ESPP provides for one month offering periods with a 15% discount from the fair market value of a share on the date of purchase. In accordance with ASC 718, *Compensation Stock Compensation*, the entire 15% purchase discount is recorded as compensation expense. A participant s combined payroll deductions and cash payments in the ESPP may not exceed $25,000 per year.

Note 5 Net Income Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Net income	**$ 25.6**	$ 8.6	**$ 62.3**	$ 17.9
Weighted average common shares outstanding	**135.0**	106.9	**134.7**	106.9
Effect of dilutive stock options	**1.0**		**1.0**	
Weighted average common shares outstanding and potential common shares	**136.0**	106.9	**135.7**	106.9
Net income per share basic and diluted	**$ 0.19**	$ 0.08	**$ 0.46**	$ 0.17

Basic net income per share was calculated by dividing net income by the weighted-average number of outstanding common shares for the period. Diluted net income per share was calculated consistent with basic net income per share including the effect of dilutive unissued common shares related to our stock-based employee compensation program. The effect of stock options on net income per share-diluted is determined through the application of the treasury stock method, whereby net proceeds received by the Company based on assumed exercises are hypothetically used to repurchase our common stock at the average market price during the period. Stock options that would have an anti-dilutive effect on net income per share are excluded from the calculations. Approximately 1.6 million and 0.6 million options were excluded from the calculation of diluted net income per share for the three and nine months ended September 30, 2010. Total options outstanding at September 30, 2010 and 2009 were 9.3 million and 9.2 million.

Note 6 Finance Receivables and Obligations Collateralized by Finance Receivables

AFC sells the majority of its U.S. dollar denominated finance receivables on a revolving basis and without recourse to a wholly owned, bankruptcy remote, consolidated, special purpose subsidiary (AFC Funding Corporation), established for the purpose of purchasing AFC s finance receivables. A securitization agreement allows for the revolving sale by AFC Funding Corporation to a bank conduit facility of undivided interests in certain eligible finance receivables subject to committed liquidity. The agreement expires on April 20, 2012. AFC Funding Corporation had committed liquidity of $450 million for U.S. finance receivables at September 30, 2010.

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

We completed an agreement for the securitization of Automotive Finance Canada, Inc. s (AFCI) receivables in February 2010. This securitization facility provides up to C$75 million in financing for eligible finance receivables. The initial funding for securitization of Canadian finance receivables resulted in net proceeds of $56.6 million and the recording of the related obligations. The agreement expires on April 20, 2012.

Accounting Standards Update 2009-16 amended ASC 860, *Transfers and Servicing*, and we adopted the new guidance on January 1, 2010. The new guidance specifies that the finance receivable transactions on or subsequent to January 1, 2010 under our revolving sale agreement be included in our balance sheet. This resulted in an increase in assets and related obligations in 2010. Obligations collateralized by finance receivables were $479.0 million at September 30, 2010. In addition, the new guidance eliminated securitization income accounting and resulted in the recording of fee and interest income and interest expense for the finance receivable transactions under the revolving sale agreement. The elimination of securitization income accounting resulted in a reduction of pre-tax income of approximately $2.8 million in the first quarter of 2010.

The following tables present quantitative information about delinquencies, credit losses less recoveries (net credit losses) and components of securitized financial assets and other related assets managed. For purposes of this illustration, delinquent receivables are defined as receivables 31 days or more past due.

	September 30, 2010 Principal Amount of:		Net Credit Losses Three Months Ended September 30, 2010	Net Credit Losses Nine Months Ended September 30, 2010
(in millions)	**Receivables**	**Receivables Delinquent**		
Floorplan receivables	**$ 706.2**	**$ 2.5**	**$ 1.5**	**$ 6.0**
Special purpose loans	**8.8**	**2.8**		
Total receivables managed	**$ 715.0**	**$ 5.3**	**$ 1.5**	**$ 6.0**

	December 31, 2009 Principal Amount of:		Net Credit Losses Three Months Ended September 30, 2009	Net Credit Losses Nine Months Ended September 30, 2009
(in millions)	**Receivables**	**Receivables Delinquent**		
Floorplan receivables	$ 145.9	$ 1.6	$ 1.1	$ 2.1
Special purpose loans	10.3	3.4		
Finance receivables held	$ 156.2	$ 5.0	$ 1.1	$ 2.1

Receivables sold	367.0
Retained interests in finance receivables sold	89.8
Total receivables managed	$ 613.0

The net credit losses for receivables sold approximated $3.4 million and $21.5 million for the three and nine months ended September 30, 2009.

At September 30, 2010, AFC managed total finance receivables of $715.0 million. At December 31, 2009, AFC managed total finance receivables of $613.0 million, of which $519.1 million had been sold without recourse to AFC Funding Corporation. Undivided interests in finance receivables were sold by AFC Funding Corporation to the bank conduit facility with recourse totaling $367.0 million at December 31, 2009. Finance

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Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

receivables include $24.6 million classified as held for sale, which are recorded at lower of cost or fair value, and $131.6 million classified as held for investment at December 31, 2009. Finance receivables classified as held for investment include $25.7 million related to receivables that were sold to the bank conduit facility that were repurchased by AFC at fair value when they became ineligible under the terms of the collateral agreement with the bank conduit facility at December 31, 2009. The face amount of these receivables was $27.5 million at December 31, 2009.

AFC s allowance for losses of $10.2 million and $5.9 million at September 30, 2010 and December 31, 2009 includes an estimate of losses for finance receivables held for investment as well as an allowance for any further deterioration in the finance receivables after they are repurchased from the bank conduit facility. Additionally, accrued liabilities of $2.4 million for the estimated losses for loans sold by the special purpose subsidiary were recorded at December 31, 2009. These loans were sold to a bank conduit facility with recourse to the special purpose subsidiary and came back on the balance sheet of the special purpose subsidiary at fair market value when they became ineligible under the terms of the collateral arrangement with the bank conduit facility.

As of December 31, 2009, the outstanding receivables sold, the retained interests in finance receivables sold and a cash reserve of 1 percent of total sold receivables serve as security for the receivables that have been sold to the bank conduit facility. As of September 30, 2010, $705.4 million of finance receivables and a cash reserve of 1 percent of finance receivables securitized serve as security for the $479.0 million of obligations collateralized by finance receivables. The amount of the cash reserve depends on circumstances which are set forth in the securitization agreements. After the occurrence of a termination event, as defined in the U.S. securitization agreement, the bank conduit facility may, and could, cause the stock of AFC Funding Corporation to be transferred to the bank conduit facility, though as a practical matter the bank conduit facility would look to the liquidation of the receivables under the transaction documents as their primary remedy.

Proceeds from the revolving sale of receivables to the bank conduit facility are used to fund new loans to customers. AFC, AFC Funding Corporation and AFCI must maintain certain financial covenants including, among others, limits on the amount of debt AFC and AFCI can incur, minimum levels of tangible net worth, and other covenants tied to the performance of the finance receivables portfolio. The securitization agreements also incorporate the financial covenants of our credit facility. At September 30, 2010, we were in compliance with the covenants in the securitization agreements.

The following table summarizes certain cash flows received from and paid to the special purpose subsidiaries (*in millions*):

	Nine Months Ended September 30,	
	2010	**2009**
Proceeds from sales of finance receivables	**N/A**	$ 2,313.6
Servicing fees received	**N/A**	$ 7.5
Proceeds received on retained interests in finance receivables sold	**$ 89.8**	$ 59.1

Our retained interests in finance receivables sold, including a nominal interest only strip, amounted to $89.8 million at December 31, 2009. Sensitivities associated with our retained interests were insignificant at all periods presented due to the short-term nature of the asset.

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Note 7 Long-Term Debt

Long-term debt consisted of the following *(in millions)*:

	Interest Rate	Maturity	September 30, 2010	December 31, 2009
Term Loan B	LIBOR + 2.75%	October 19, 2013	**$ 1,219.6**	$ 1,247.9
$250 million revolving credit facility	LIBOR + 2.75%	April 19, 2013		
Floating rate senior notes	LIBOR + 4.00%	May 1, 2014	**150.0**	150.0
Senior notes	8.75%	May 1, 2014	**450.0**	450.0
Senior subordinated notes	10%	May 1, 2015	**199.4**	425.0
Canadian line of credit	CAD Prime + 1.5%			
Total debt			**2,019.0**	2,272.9
Less current portion of long-term debt				225.6
Long-term debt			**$ 2,019.0**	$ 2,047.3

Credit Facilities

In 2007, we entered into senior secured credit facilities, comprised of a $300.0 million revolving credit facility and a $1,565.0 million term loan (Term Loan B in the table above). The revolver was entered into for working capital and general corporate purposes. In 2009, we entered into an amendment to the Credit Agreement. As part of the amendment, available borrowings under the revolving credit facility were reduced to $250 million and the revolving credit facility and Term Loan B interest rate were increased to LIBOR plus a margin of 2.75% from LIBOR plus a margin of 2.25%. There were no borrowings under the revolving credit facility at September 30, 2010 or December 31, 2009, although we had related outstanding letters of credit in the aggregate amount of $33.7 million and $31.7 million at September 30, 2010 and December 31, 2009, respectively, which reduce the amount available for borrowings under our credit facility.

The senior secured credit facilities are guaranteed by KAR Auction Services and each of our direct and indirect present and future material domestic subsidiaries, subject to certain exceptions (excluding among others, AFC Funding Corporation). The senior secured credit facilities are secured by a perfected first priority security interest in, and mortgages on, all present and future tangible and intangible assets of the Company and the guarantors, and our capital stock and that of each of our direct and indirect material domestic subsidiaries and 65% of the capital stock of certain foreign subsidiaries.

The terms of the Credit Agreement include a 0.5% commitment fee based on unutilized amounts, letter of credit fees and agency fees. The Credit Agreement also includes covenants that, among other things, limit or restrict us and our subsidiaries abilities to dispose of assets, incur additional indebtedness, incur guarantee obligations, prepay other indebtedness, including the senior notes, pay dividends, create liens, make equity or debt investments, make acquisitions, modify the terms of the indenture, engage in mergers, make capital expenditures and engage in certain transactions with affiliates. In addition, the senior secured credit facilities are subject to a senior secured leverage ratio test, provided there are revolving loans outstanding. There were no revolving loans outstanding at September 30, 2010. We were in compliance with the covenants in the credit facility at September 30, 2010.

Senior Notes

In 2007, we issued $450.0 million of 8.75% senior notes and $150.0 million of floating rate senior notes both of which are due May 1, 2014. In addition, we issued $425.0 million of 10% senior subordinated notes due

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September 30, 2010 (Unaudited)

May 1, 2015. In connection with our initial public offering, we conducted a cash tender offer for certain of the notes described above. The tender offer was oversubscribed and as such, in accordance with the identified priority levels, only a portion of the 10% senior subordinated notes were accepted for prepayment. In January 2010, we prepaid $225.6 million principal amount of the 10% senior subordinated notes with proceeds received from the initial public offering and the underwriters option to purchase additional shares. This amount was included in Current maturities of long-term debt on the consolidated balance sheet at December 31, 2009. We incurred a loss on the extinguishment of the notes of $25.3 million in the first quarter of 2010.

Fair Value of Debt

As of September 30, 2010, the estimated fair value of our long-term debt amounted to $2,001.5 million. The estimates of fair value are based on the market prices for our publicly-traded debt as of September 30, 2010. The estimates presented on long-term financial instruments are not necessarily indicative of the amounts that would be realized in a current market exchange.

Note 8 Derivatives

We are exposed to interest rate risk on our variable rate borrowings. Accordingly, interest rate fluctuations affect the amount of interest expense we are obligated to pay. Our July 2007 interest rate swap agreement with a notional amount of $800 million matured on June 30, 2009. In May 2009, we entered into an interest rate swap agreement with a notional amount of $650 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility. The interest rate swap agreement had an effective date of June 30, 2009, matures on June 30, 2012 and effectively results in a fixed LIBOR interest rate of 2.19% on $650 million of the Term Loan B credit facility. We are exposed to credit loss in the event of non-performance by the counterparty; however, non-performance is not anticipated.

In May 2009, we also purchased an interest rate cap for $1.3 million with a notional amount of $250 million to manage our exposure to interest rate movements on our variable rate Term Loan B credit facility when one-month LIBOR exceeds 2.5%. The interest rate cap relates to a portion of the variable rate debt that is not covered by our interest rate swap agreement. The interest rate cap agreement had an effective date of June 30, 2009 and matures on June 30, 2011. The unamortized portion of the $1.3 million investment is recorded in Other current assets on the consolidated balance sheet and is being amortized over the remaining life of the interest rate cap to interest expense. We are exposed to credit loss in the event of non-performance by the counterparty; however, non-performance is not anticipated.

KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

ASC 815 requires companies to recognize all derivative instruments as either assets or liabilities at fair value in the balance sheet. In accordance with ASC 815, we have designated our interest rate derivatives as cash flow hedges. The fair values of the interest rate derivatives are based on quoted market prices for similar instruments from a commercial bank. The following table presents the fair value of our interest rate derivatives included in the consolidated balance sheet for the periods presented (*in millions*):

	Asset Derivatives				Liability Derivatives			
	September 30, 2010		December 31, 2009		September 30, 2010		December 31, 2009	
Derivatives Designated as Hedging Instruments Under ASC 815	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**	**Balance Sheet Location**	**Fair Value**
$650 million notional interest rate swap	Other assets	**$**	Other assets	$	Other accrued expenses	**$ 20.0**	Other accrued expenses	$ 8.7
$250 million notional interest rate cap	Other current assets	**$**	Other assets	$ 0.6	Other accrued expenses	**$**	Other accrued expenses	$

The earnings impact of the interest rate derivatives designated as cash flow hedges are recorded upon the recognition of the interest related to the hedged debt. Any ineffectiveness in the hedging relationships is recognized in current earnings. There was no significant ineffectiveness in the first nine months of 2010 or 2009. Unrealized gains or losses on the interest rate derivatives are included as a component of Accumulated other comprehensive income. At September 30, 2010, there was a net unrealized loss totaling $12.7 million, net of tax benefits of $7.8 million. At December 31, 2009, there was a net unrealized loss totaling $5.7 million, net of tax benefits of $3.5 million. The following table presents the effect of the interest rate derivatives on our statement of equity and consolidated statements of income for the periods presented (*in millions*):

Derivatives in ASC 815	**Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion)**		**Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**	**Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**	
	Three Months Ended September 30,			**Three Months Ended September 30,**	
Cash Flow Hedging Relationships	**2010**	**2009**		**2010**	**2009**
$800 million notional interest rate swap	**N/A**	N/A	Interest expense	**N/A**	N/A
$650 million notional interest rate swap	**($2.1)**	($ 5.9)	Interest expense	**($ 3.1)**	($ 3.2)
$250 million notional interest rate cap	**$0.1**	($ 0.3)	N/A	**$**	$

Derivatives in ASC 815	**Amount of Gain / (Loss) Recognized in OCI on Derivative (Effective Portion)**	**Location of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**	**Amount of Gain / (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)**
	Nine Months Ended September 30,		**Nine Months Ended September 30,**

Cash Flow Hedging Relationships	2010	2009		2010	2009
$800 million notional interest rate swap	**N/A**	$ 16.3	Interest expense	**N/A**	($ 16.1)
$650 million notional interest rate swap	**($11.2)**	($ 9.7)	Interest expense	**($ 9.4)**	($ 3.2)
$250 million notional interest rate cap	**($0.1)**	($ 0.3)	N/A	**$**	$

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Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Note 9 Comprehensive Income

The components of comprehensive income are as follows (*in millions*):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Net income	**$ 25.6**	$ 8.6	**$ 62.3**	$ 17.9
Other comprehensive income (loss), net of tax				
Foreign currency translation gain	**8.6**	21.2	**3.7**	31.4
Unrealized gain (loss) on interest rate derivatives	**(1.2)**	(3.9)	**(7.0)**	4.1
Comprehensive income	**$ 33.0**	$ 25.9	**$ 59.0**	$ 53.4

The composition of Accumulated other comprehensive income at September 30, 2010, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $12.7 million, a $0.3 million unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $28.5 million. The composition of Accumulated other comprehensive income at December 31, 2009, net of related tax effects, consisted of the net unrealized loss on the interest rate derivatives of $5.7 million, a $0.3 million unrealized gain on post-retirement benefit obligation and a foreign currency translation gain of $24.8 million.

Note 10 Fair Value Measurements

We apply ASC 820, *Fair Value Measurements and Disclosures*, to our financial assets and liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The standard establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly. Level 2 inputs include quoted prices for similar assets or liabilities in active markets; quoted prices in markets that are not active; or other inputs that are observable or can be derived principally from or corroborated by observable market data for substantially the full term of the assets or liabilities, such as models or other valuation methodologies.

Level 3 Unobservable inputs that are based on our assumptions are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Unobservable inputs reflect our own assumptions about the assumptions that market participants would use in pricing the asset or liability. Level 3 assets and liabilities include instruments for which the determination of fair value requires significant management judgment or estimation.

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September 30, 2010 (Unaudited)

The following tables summarize our financial assets and liabilities measured at fair value on a recurring basis in accordance with ASC 820 (*in millions*):

Description	September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Interest rate cap	**$**	$	$	$
Liabilities:				
Interest rate swap	**$ 20.0**	$	$ 20.0	$

Description	December 31, 2009	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Retained interest	$ 89.8	$	$	$ 89.8
Interest rate cap	0.6		0.6	
Liabilities:				
Interest rate swap	$ 8.7	$	$ 8.7	$

Retained Interest The fair value of the retained interest in finance receivables sold prior to January 1, 2010 was based upon our estimates of future cash flows, using assumptions that market participants would use to value such investments, including estimates of anticipated credit losses over the life of the finance receivables sold. The cash flows were discounted using a market discount rate. The recorded fair value, however, required significant management judgment or estimation and may not necessarily have represented what we would have received in an actual sale of the receivables.

Interest Rate Swap Under the interest rate swap agreement, we pay a fixed LIBOR rate on a notional amount and receive a variable LIBOR rate which effectively hedges a portion of the Term Loan B credit facility. The fair value of the interest rate swap is based on quoted market prices for similar instruments from a commercial bank.

Interest Rate Cap Under the interest rate cap agreement, we will receive interest on a notional amount when one-month LIBOR exceeds 2.5%. This agreement effectively hedges a portion of the Term Loan B credit facility. The fair value of the interest rate cap is based on quoted market prices for similar instruments from a commercial bank.

Note 11 Segment Information

ASC 280, *Segment Reporting,* requires reporting of segment information that is consistent with the manner in which the chief operating decision maker operates and views the Company. We have three reportable business segments: ADESA Auctions, IAAI and AFC. These reportable segments offer different services and are managed separately based on the fundamental differences in their operations.

The holding company is maintained separately from the three reportable segments and includes expenses associated with the corporate office, such as salaries, benefits, and travel costs for the corporate management team, certain human resources, information technology and accounting costs, and incremental insurance,

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September 30, 2010 (Unaudited)

treasury, legal and risk management costs. Holding company interest expense includes the interest expense incurred on the corporate debt structure. Intercompany charges relate primarily to interest on intercompany debt or receivables and certain information technology costs allocated by the holding company.

Financial information regarding our reportable segments is set forth below for the three months ended September 30, 2010 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 267.4	$ 142.3	$ 35.6	$	$ 445.3
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	147.7	86.6	7.3		241.6
Selling, general and administrative	52.2	17.9	5.0	15.3	90.4
Depreciation and amortization	21.6	14.3	6.2	0.1	42.2
Total operating expenses	221.5	118.8	18.5	15.4	374.2
Operating profit (loss)	45.9	23.5	17.1	(15.4)	71.1
Interest expense	0.3	0.6	1.9	32.7	35.5
Other (income) expense, net	(0.3)	(0.2)		(0.6)	(1.1)
Intercompany expense (income)	9.6	9.5	(3.0)	(16.1)	
Income (loss) before income taxes	36.3	13.6	18.2	(31.4)	36.7
Income taxes	13.7	5.1	6.7	(14.4)	11.1
Net income (loss)	$ 22.6	$ 8.5	$ 11.5	($ 17.0)	$ 25.6
Assets	$ 2,233.9	$ 1,199.1	$ 1,168.7	$ 147.4	$ 4,749.1

Financial information regarding our reportable segments is set forth below for the three months ended September 30, 2009 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 270.8	$ 135.5	$ 23.8	$	$ 430.1
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	146.1	86.4	7.1		239.6
Selling, general and administrative	52.2	21.4	2.6	25.2	101.4
Depreciation and amortization	21.0	14.3	6.1	0.2	41.6
Total operating expenses	219.3	122.1	15.8	25.4	382.6

Operating profit (loss)	51.5	13.4	8.0	(25.4)	47.5
Interest expense	0.2	0.4		38.7	39.3
Other (income) expense, net	(0.2)	(0.3)		(4.3)	(4.8)
Intercompany expense (income)	9.1	10.9	(1.6)	(18.4)	
Income (loss) before income taxes	42.4	2.4	9.6	(41.4)	13.0
Income taxes	12.7	1.0	3.7	(13.0)	4.4
Net income (loss)	$ 29.7	$ 1.4	$ 5.9	($ 28.4)	$ 8.6
Assets	$ 2,130.2	$ 1,170.6	$ 651.3	$ 382.4	$ 4,334.5

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September 30, 2010 (Unaudited)

Financial information regarding our reportable segments is set forth below for the nine months ended September 30, 2010 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 821.1	$ 458.4	$ 94.2	$	$ 1,373.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	456.5	271.9	20.9		749.3
Selling, general and administrative	158.0	58.5	13.5	46.2	276.2
Depreciation and amortization	64.6	43.7	18.6	0.4	127.3
Total operating expenses	679.1	374.1	53.0	46.6	1,152.8
Operating profit (loss)	142.0	84.3	41.2	(46.6)	220.9
Interest expense	0.8	1.7	5.1	98.7	106.3
Other income, net	(0.5)	(0.8)		(1.4)	(2.7)
Loss on extinguishment of debt				25.3	25.3
Intercompany expense (income)	31.0	28.6	(8.5)	(51.1)	
Income (loss) before income taxes	110.7	54.8	44.6	(118.1)	92.0
Income taxes	38.7	21.5	17.4	(47.9)	29.7
Net income (loss)	$ 72.0	$ 33.3	$ 27.2	($ 70.2)	$ 62.3

Financial information regarding our reportable segments is set forth below for the nine months ended September 30, 2009 *(in millions)*:

	ADESA Auctions	IAAI	AFC	Holding Company	Consolidated
Operating revenues	$ 838.6	$ 412.5	$ 60.6	$	$ 1,311.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)	468.1	264.5	22.5		755.1
Selling, general and administrative	157.2	52.1	8.1	56.9	274.3
Depreciation and amortization	66.8	43.9	18.4	0.8	129.9
Total operating expenses	692.1	360.5	49.0	57.7	1,159.3
Operating profit (loss)	146.5	52.0	11.6	(57.7)	152.4
Interest expense (income)	0.5	1.0		131.3	132.8
Other (income) expense, net	(2.0)	(1.2)	1.2	(7.3)	(9.3)

Intercompany expense (income)	27.1	31.8	(5.4)	(53.5)	
Income (loss) before income taxes	120.9	20.4	15.8	(128.2)	28.9
Income taxes	43.7	8.4	5.7	(46.8)	11.0
Net income (loss)	$ 77.2	$ 12.0	$ 10.1	($ 81.4)	$ 17.9

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Note 12 Commitments and Contingencies

We are involved in litigation and disputes arising in the ordinary course of business, such as actions related to injuries; property damage; handling, storage or disposal of vehicles; environmental laws and regulations; and other litigation incidental to the business such as employment matters and dealer disputes. Management considers the likelihood of loss or the incurrence of a liability, as well as the ability to reasonably estimate the amount of loss, in determining loss contingencies. We accrue an estimated loss contingency when it is probable that a liability has been incurred and the amount of loss (or range of possible losses) can be reasonably estimated. Management regularly evaluates current information available to determine whether accrual amounts should be adjusted. Accruals for contingencies including litigation and environmental matters are included in Other accrued expenses at undiscounted amounts and exclude claims for recoveries from insurance or other third parties. These accruals are adjusted periodically as assessment and remediation efforts progress, or as additional technical or legal information becomes available. If the amount of an actual loss is greater than the amount accrued, this could have an adverse impact on our operating results in that period. Legal fees are expensed as incurred.

We have accrued, as appropriate, for environmental remediation costs anticipated to be incurred at certain of our auction facilities. Liabilities for environmental matters included in Other accrued expenses were $0.8 million and $1.1 million at September 30, 2010 and December 31, 2009. No amounts have been accrued as receivables for potential reimbursement or recoveries to offset this liability.

We store a significant number of vehicles owned by various customers that are consigned to us to be auctioned. We are contingently liable for each consigned vehicle until the eventual sale or other disposition, subject to certain natural disaster exceptions. Individual stop loss and aggregate insurance coverage is maintained on the consigned vehicles. These consigned vehicles are not included in the consolidated balance sheets.

In the normal course of business, we also enter into various other guarantees and indemnities in our relationships with suppliers, service providers, customers and others. These guarantees and indemnifications do not materially impact our financial condition or results of operations, but indemnifications associated with our actions generally have no dollar limitations and currently cannot be quantified.

As noted above, we are involved in litigation and disputes arising in the ordinary course of business, such as actions related to injuries; property damage; handling, storage or disposal of vehicles; environmental laws and regulations; and other litigation incidental to the business such as employment matters and dealer disputes. Such litigation is generally not, in the opinion of management, likely to have a material adverse effect on our financial condition, results of operations or cash flows. Legal and regulatory proceedings which could be material are discussed below.

IAAI Lower Duwamish Waterway

On March 25, 2008, the United States Environmental Protection Agency, or EPA, issued a General Notice of Potential Liability pursuant to Section 107(a), and a Request for Information pursuant to Section 104(e) of the Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA to IAAI for a Superfund site known as the Lower Duwamish Waterway Superfund Site in Seattle, Washington, or LDW. At this time, the EPA has not demanded that IAAI pay any funds or take any action apart from responding to the Section 104(e) Information Request. The EPA has advised IAAI that, to date, it has sent out approximately 60 general notice letters to other parties, and has sent Section 104(e) Requests to more than 250 other parties. A remedial investigation has been conducted for this site by some of the potentially responsible parties, who have

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September 30, 2010 (Unaudited)

also commenced a feasibility study pursuant to CERCLA. IAAI is aware that certain authorities plan to bring Natural Resource Damage claims against potentially responsible parties. In addition, the Washington State Department of Ecology, or Ecology is working with the EPA in relation to LDW, primarily to investigate and address sources of potential contamination contributing to LDW. IAAI and the owner and predecessor at their Tukwila location, which is adjacent to the LDW, are currently in discussion with Ecology concerning possible source control obligations, including an investigation of the water and soils entering the stormwater system, an analysis of the source of any contamination identified within the system and possible repairs and upgrades to the stormwater capture and filtration system. In 2010, IAAI began implementing a stormwater sampling plan to comply with Ecology source control requirements.

Note 13 Subsequent Event

In November 2010, ADESA completed the purchase of certain assets of six used vehicle auctions from The Premier Auction Group (PAG). The six locations include: Bay City, Michigan; Clare, Michigan; Fall Branch, Tennessee; Montpelier, Ohio; Las Vegas, Nevada; and Lomira, Wisconsin. The acquisition expands our footprint in Michigan, Tennessee, Ohio, Wisconsin and Nevada. Financial results for these site acquisitions will be included in our consolidated financial statements from the date of acquisition. The purchase price allocations for each auction will occur in the fourth quarter ending December 31, 2010.

Note 14 Supplemental Guarantor Information

Our obligations related to our term loan, revolving credit facility, 10% senior subordinated notes, 8 3/4% senior notes and floating rate senior notes are guaranteed on a full, unconditional, joint and several basis by certain direct and indirect present and future domestic subsidiaries (the Guarantor Subsidiaries). AFC Funding Corporation and all of our foreign subsidiaries are not guarantors (the Non-Guarantor Subsidiaries). The following financial information sets forth, on a condensed consolidating basis, the balance sheets, statements of income and statements of cash flows for the periods indicated for KAR Auction Services, the Guarantor Subsidiaries, the Non-Guarantor Subsidiaries and the eliminations to arrive at KAR Auction Services on a consolidated basis.

The condensed consolidating financial statements are provided as an alternative to filing separate financial statements of the Guarantor Subsidiaries. The condensed consolidating financial statements should be read in conjunction with our consolidated financial statements and notes thereto.

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September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Income

For the Three Months Ended September 30, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 338.3	$ 107.0	$	$ 445.3
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		205.2	36.4		241.6
Selling, general and administrative	1.5	77.0	11.9		90.4
Depreciation and amortization		36.4	5.8		42.2
Total operating expenses	1.5	318.6	54.1		374.2
Operating profit (loss)	(1.5)	19.7	52.9		71.1
Interest expense	17.6	15.0	2.9		35.5
Other (income) expense, net		(1.0)	(0.1)		(1.1)
Intercompany expense (income)		(4.5)	4.5		
Income (loss) before income taxes	(19.1)	10.2	45.6		36.7
Income taxes	(8.8)	3.9	16.0		11.1
Net income (loss)	($ 10.3)	$ 6.3	$ 29.6	$	$ 25.6

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Income

For the Three Months Ended September 30, 2009

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 337.5	$ 92.6	$	$ 430.1
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		203.1	36.5		239.6
Selling, general and administrative	10.9	77.8	12.7		101.4
Depreciation and amortization		36.0	5.6		41.6
Total operating expenses	10.9	316.9	54.8		382.6
Operating profit (loss)	(10.9)	20.6	37.8		47.5
Interest expense	20.7	17.4	1.2		39.3
Other income, net		(4.7)	(0.1)		(4.8)
Intercompany (income) expense		(5.4)	5.4		
Income (loss) before income taxes	(31.6)	13.3	31.3		13.0
Income taxes	(9.4)	2.4	11.4		4.4
Net income (loss)	($ 22.2)	$ 10.9	$ 19.9	$	$ 8.6

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Income

For the Nine Months Ended September 30, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 1,047.8	$ 325.9	$	$ 1,373.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		630.1	119.2		749.3
Selling, general and administrative	1.9	237.9	36.4		276.2
Depreciation and amortization		109.8	17.5		127.3
Total operating expenses	1.9	977.8	173.1		1,152.8
Operating profit (loss)	(1.9)	70.0	152.8		220.9
Interest expense	53.5	43.2	9.6		106.3
Other income, net		(2.1)	(0.6)		(2.7)
Loss on extinguishment of debt	25.3				25.3
Intercompany expense (income)		(13.6)	13.6		
Income (loss) before income taxes	(80.7)	42.5	130.2		92.0
Income taxes	(31.1)	14.6	46.2		29.7
Net income (loss)	($ 49.6)	$ 27.9	$ 84.0	$	$ 62.3

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Income

For the Nine Months Ended September 30, 2009

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Operating revenues	$	$ 1,058.2	$ 253.5	$	$ 1,311.7
Operating expenses					
Cost of services (exclusive of depreciation and amortization)		645.8	109.3		755.1
Selling, general and administrative	15.0	225.7	33.6		274.3
Depreciation and amortization		113.3	16.6		129.9
Total operating expenses	15.0	984.8	159.5		1,159.3
Operating profit (loss)	(15.0)	73.4	94.0		152.4
Interest expense	79.6	49.9	3.3		132.8
Other income, net		(8.2)	(1.1)		(9.3)
Intercompany expense (income)		(11.5)	11.5		
Income (loss) before income taxes	(94.6)	43.2	80.3		28.9
Income taxes	(34.0)	16.7	28.3		11.0
Net income (loss)	($ 60.6)	$ 26.5	$ 52.0	$	$ 17.9

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Balance Sheet

As of September 30, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
Current assets					
Cash and cash equivalents	$	$ 345.7	$ 34.1	$	$ 379.8
Restricted cash			6.1		6.1
Trade receivables, net of allowances		284.7	85.9	(14.6)	356.0
Finance receivables, net of allowances		9.3	111.1		120.4
Finance receivables securitized, net of allowances			584.4		584.4
Deferred income tax assets	1.6	41.0			42.6
Other current assets	0.5	36.6	3.9		41.0
Total current assets	2.1	717.3	825.5	(14.6)	1,530.3
Other assets					
Investments in and advances to affiliates, net	2,639.8	158.4	68.9	(2,867.1)	
Goodwill		1,524.6	3.9		1,528.5
Customer relationships, net of accumulated amortization		597.0	106.5		703.5
Other intangible assets, net of accumulated amortization		254.1	8.8		262.9
Unamortized debt issuance costs	45.0				45.0
Other assets		11.2	1.0		12.2
Total other assets	2,684.8	2,545.3	189.1	(2,867.1)	2,552.1
Property and equipment, net of accumulated depreciation		528.7	138.0		666.7
Total assets	$ 2,686.9	$ 3,791.3	$ 1,152.6	($ 2,881.7)	$ 4,749.1

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Balance Sheet

As of September 30, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders Equity					
Current liabilities					
Accounts payable	$	$ 385.4	$ 63.3	($ 14.6)	$ 434.1
Accrued employee benefits and compensation expenses		45.5	4.1		49.6
Accrued interest	26.0		0.1		26.1
Other accrued expenses	5.3	65.4	12.0		82.7
Obligations collateralized by finance receivables			479.0		479.0
Total current liabilities	31.3	496.3	558.5	(14.6)	1,071.5
Non-current liabilities					
Investments by and advances from affiliates, net	95.2			(95.2)	
Long-term debt	1,197.5	821.5			2,019.0
Deferred income tax liabilities	(6.2)	307.6	26.4		327.8
Other liabilities	20.0	85.9	6.1		112.0
Total non-current liabilities	1,306.5	1,215.0	32.5	(95.2)	2,458.8
Commitments and contingencies					
Stockholders equity					
Total stockholders equity	1,349.1	2,080.0	561.6	(2,771.9)	1,218.8
Total liabilities and stockholders equity	$ 2,686.9	$ 3,791.3	$ 1,152.6	($ 2,881.7)	$ 4,749.1

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Balance Sheet

As of December 31, 2009

(In millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Assets					
Current assets					
Cash and cash equivalents	$	$ 339.8	$ 24.1	$	$ 363.9
Restricted cash		3.7	5.6		9.3
Trade receivables, net of allowances	0.2	215.3	42.5	(7.6)	250.4
Finance receivables, net of allowances		2.9	147.4		150.3
Retained interests in finance receivables sold			89.8		89.8
Deferred income tax assets	1.4	35.9			37.3
Other current assets	0.2	37.4	3.3		40.9
Total current assets	1.8	635.0	312.7	(7.6)	941.9
Other assets					
Investments in and advances to affiliates, net	2,895.1		74.1	(2,969.2)	
Goodwill		1,524.3	3.8		1,528.1
Customer relationships, net of accumulated amortization		642.1	111.2		753.3
Other intangible assets, net of accumulated amortization		255.8	11.0		266.8
Unamortized debt issuance costs	61.6				61.6
Other assets	0.6	15.1	0.7		16.4
Total other assets	2,957.3	2,437.3	200.8	(2,969.2)	2,626.2
Property and equipment, net of accumulated depreciation		541.8	141.4		683.2
Total assets	$ 2,959.1	$ 3,614.1	$ 654.9	($ 2,976.8)	$ 4,251.3

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Balance Sheet

As of December 31, 2009

(In millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Liabilities and Stockholders Equity					
Current liabilities					
Accounts payable	$	$ 247.2	$ 23.1	($ 7.6)	$ 262.7
Accrued employee benefits and compensation expenses		49.8	6.6		56.4
Accrued interest	14.8				14.8
Other accrued expenses	6.2	67.4	6.6		80.2
Income taxes payable		1.3	1.4		2.7
Current maturities of long-term debt	225.6				225.6
Total current liabilities	246.6	365.7	37.7	(7.6)	642.4
Non-current liabilities					
Investments by and advances from affiliates, net	72.6	124.7		(197.3)	
Long-term debt	1,225.8	716.0	105.5		2,047.3
Deferred income tax liabilities	(2.1)	300.3	30.0		328.2
Other liabilities	8.7	77.4	5.8		91.9
Total non-current liabilities	1,305.0	1,218.4	141.3	(197.3)	2,467.4
Commitments and contingencies					
Stockholders equity					
Total stockholders equity	1,407.5	2,030.0	475.9	(2,771.9)	1,141.5
Total liabilities and stockholders equity	$ 2,959.1	$ 3,614.1	$ 654.9	($ 2,976.8)	$ 4,251.3

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 30, 2010

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash provided by operating activities	$ 268.2	$ 8.2	$ 141.6	$	$ 418.0
Investing activities					
Net decrease (increase) in finance receivables held for investment		3.6	(613.0)		(609.4)
Acquisition of businesses, net of cash acquired		(2.7)			(2.7)
Purchases of property, equipment and computer software		(40.7)	(1.2)		(41.9)
Purchases of other intangibles		(0.5)			(0.5)
Proceeds from sale of property, equipment and computer software		2.0			2.0
(Increase) decrease in restricted cash		3.7	(0.5)		3.2
Net cash used by investing activities		(34.6)	(614.7)		(649.3)
Financing activities					
Net increase (decrease) in book overdrafts		33.2	4.1		37.3
Net increase in obligations collateralized by finance receivables			479.0		479.0
Payments on long-term debt	(28.3)				(28.3)
Payment for early extinguishment of debt	(243.6)				(243.6)
Payments on capital leases		(3.1)	(0.3)		(3.4)
Issuance of common stock under stock plans	3.7				3.7
Excess tax benefits from stock-based compensation		2.2			2.2
Net cash provided by (used by) financing activities	(268.2)	32.3	482.8		246.9
Effect of exchange rate changes on cash			0.3		0.3
Net increase (decrease) in cash and cash equivalents		5.9	10.0		15.9
Cash and cash equivalents at beginning of period		339.8	24.1		363.9
Cash and cash equivalents at end of period	$	$ 345.7	$ 34.1	$	$ 379.8

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KAR Auction Services, Inc.

Notes to Consolidated Financial Statements (Continued)

September 30, 2010 (Unaudited)

Condensed Consolidating Statement of Cash Flows

For the Nine Months Ended September 30, 2009

(In millions)

(Unaudited)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations and Adjustments	Total
Net cash provided by operating activities	$ 1.6	$ 228.2	$ 9.3	$	$ 239.1
Investing activities					
Net decrease (increase) in finance receivables held for investment		9.2	(12.0)		(2.8)
Acquisition of businesses, net of cash acquired		(4.1)			(4.1)
Purchases of property, equipment and computer software		(38.7)	(2.1)		(40.8)
Proceeds from sale of property, equipment and computer software		0.3			0.3
(Increase) decrease in restricted cash			7.1		7.1
Net cash used by investing activities		(33.3)	(7.0)		(40.3)
Financing activities					
Net increase (decrease) in book overdrafts		34.1	(3.3)		30.8
Net increase (decrease) in borrowings from lines of credit			(4.5)		(4.5)
Payments for debt issuance costs	(0.3)				(0.3)
Payments on capital leases		(1.8)	(0.4)		(2.2)
Initial net investment for interest rate cap	(1.3)				(1.3)
Net cash provided by (used by) financing activities	(1.6)	32.3	(8.2)		22.5
Effect of exchange rate changes on cash			1.1		1.1
Net increase (decrease) in cash and cash equivalents		227.2	(4.8)		222.4
Cash and cash equivalents at beginning of period		129.5	28.9		158.4
Cash and cash equivalents at end of period	$	$ 356.7	$ 24.1	$	$ 380.8

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and which are subject to certain risks, trends and uncertainties. In particular, statements made in this report on Form 10-Q that are not historical facts (including, but not limited to, expectations, estimates, assumptions and projections regarding the industry, business, future operating results, potential acquisitions and anticipated cash requirements) may be forward-looking statements. Words such as should, may, will, anticipates, expects, intends, plans, believes, seeks, estimates, and similar expressions identify forward-looking statements. Such state including statements regarding our future growth; anticipated cost savings, revenue increases and capital expenditures; strategic initiatives, greenfields and acquisitions; our competitive position; and our continued investment in information technology are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from the results projected, expressed or implied by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in Item 1A Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2009 and filed on February 25, 2010. Some of these factors include:

- fluctuations in consumer demand for and in the supply of used, leased and salvage vehicles and the resulting impact on auction sales volumes, conversion rates and loan transaction volumes;
- trends in new and used vehicle sales and incentives, including wholesale used vehicle pricing;
- the ability of consumers to lease or finance the purchase of new and/or used vehicles;
- the ability to recover or collect from delinquent or bankrupt customers;