

ADESA INC
Form 10-Q
August 12, 2005

**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 June 30, 2005

Commission File Number 001-32198

ADESA, Inc.

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

35-1842546
(I.R.S. Employer
Identification No.)

**13085 Hamilton Crossing Boulevard
Carmel, Indiana 46032**

(Address of principal executive offices)

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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of common stock outstanding as of August 9, 2005:

Class	Number of Shares Outstanding
Common	89,533,971

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

ADESA, Inc.
Consolidated Statements of Income
(In millions, except per share data)
(unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2005	2004	June 30, 2005	2004
Operating revenues				
Auction and related services	\$ 215.5	\$ 202.6	\$ 430.5	\$ 421.0
Dealer financing	32.2	28.4	61.2	57.3
Total operating revenues	247.7	231.0	491.7	478.3
Operating expenses				
Cost of services	115.8	110.8	231.0	231.6
Selling, general and administrative	56.7	53.6	112.2	112.8
Depreciation and amortization	10.0	8.9	19.2	18.1
Total operating expenses	182.5	173.3	362.4	362.5
Operating profit	65.2	57.7	129.3	115.8
Interest expense	8.5	4.7	16.6	8.7
Other income, net	(2.3)	(0.6)	(3.8)	(1.4)
Income from continuing operations before income taxes	59.0	53.6	116.5	108.5
Income taxes	23.0	21.0	45.5	42.6
Income from continuing operations	36.0	32.6	71.0	65.9
Loss from discontinued operations net of income taxes	(0.1)	(4.0)	(0.1)	(4.0)
Net income	\$ 35.9	\$ 28.6	\$ 70.9	\$ 61.9
Earnings per share - basic				
Income from continuing operations	\$ 0.40	\$ 0.36	\$ 0.79	\$ 0.74
Loss from discontinued operations, net of income taxes		(0.04)		(0.05)
Net income	\$ 0.40	\$ 0.32	\$ 0.79	\$ 0.69
Earnings per share - diluted				
Income from continuing operations	\$ 0.40	\$ 0.36	\$ 0.78	\$ 0.74
Loss from discontinued operations, net of income taxes		(0.04)		(0.05)
Net income	\$ 0.40	\$ 0.32	\$ 0.78	\$ 0.69
Dividends declared per common share (Note 12)	\$ 0.075	\$	\$ 0.15	\$

See notes to consolidated financial statements

ADESA, Inc.
Consolidated Balance Sheets
(In millions, except share data)

	June 30, 2005 <i>(unaudited)</i>	December 31, 2004
Assets		
<i>Current assets</i>		
Cash and cash equivalents	\$ 254.0	\$ 309.4
Trade receivables, net of allowances of \$6.7 (2005) and \$7.5 (2004)	293.8	161.1
Finance receivables, net of allowances of \$4.7 (2005) and \$4.3 (2004)	283.1	218.6
Deferred income taxes	29.5	28.0
Other current assets	15.8	13.7
Total current assets	876.2	730.8
<i>Other assets</i>		
Goodwill	525.3	514.6
Other intangible assets, net of accumulated amortization of \$24.6 (2005) and \$25.2 (2004)	38.5	31.6
Other assets	55.9	58.3
Total other assets	619.7	604.5
Property and equipment, net of accumulated depreciation of \$142.9 (2005) and \$130.2 (2004)	594.4	578.2
Total assets	\$ 2,090.3	\$ 1,913.5

See notes to consolidated financial statements

ADESA, Inc.
Consolidated Balance Sheets
(In millions, except share data)

	June 30, 2005 <i>(unaudited)</i>	December 31, 2004
Liabilities and Stockholders Equity		
<i>Current liabilities</i>		
Accounts payable	\$ 409.9	\$ 227.3
Employee benefits and compensation	32.4	40.4
Other accrued expenses	38.2	36.0
Income taxes payable	18.2	25.3
Current maturities of long-term debt	37.1	37.1
Current liabilities of discontinued operations	6.7	6.5
Total current liabilities	542.5	372.6
<i>Non-current liabilities</i>		
Long-term debt	460.5	479.0
Deferred tax liabilities	45.8	42.1
Other liabilities	7.6	8.4
Total non-current liabilities	513.9	529.5
Commitments and contingencies (Note 13)		
<i>Stockholders equity</i>		
Preferred stock, \$0.01 par value:		
Authorized shares: 50,000,000		
Issued shares: none		
Common stock, \$0.01 par value:		
Authorized shares: 500,000,000		
Issued shares: 94,868,104 (2005 and 2004)	1.0	1.0
Additional paid-in capital	670.8	675.1
Retained earnings	439.6	382.2
Unearned compensation	(3.3)	(3.1)
Treasury stock, at cost:		
Shares: 5,352,286 (2005)		
4,343,478 (2004)	(112.3)	(85.9)
Accumulated other comprehensive income	38.1	42.1
Total stockholders equity	1,033.9	1,011.4
Total liabilities and stockholders equity	\$ 2,090.3	\$ 1,913.5

See notes to consolidated financial statements

ADESA, Inc.
Consolidated Statements of Stockholders' Equity
(In millions)

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	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Retained Earnings	Unearned Compensation	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
Balance at December 31, 2004	94.9	\$ 1.0	\$ 675.1	\$ 382.2	\$ (3.1)	\$ (85.9)	\$ 42.1	\$ 1,011.4
Comprehensive income:								
Net income				70.9				70.9
Other comprehensive income (loss), net of tax:								
Foreign currency translation							(4.7)	
Unrealized gain on interest rate swaps							0.7	
Other comprehensive loss								(4.0)
Comprehensive income								66.9
Cash dividends paid to stockholders				(13.5)				(13.5)
Issuance of common stock under stock plans			(6.3)		(0.2)	17.0		10.5
Tax benefits from employee stock plans			2.0					2.0
Repurchase of common stock						(43.4)		(43.4)
Balance at June 30, 2005 <i>(unaudited)</i>	94.9	\$ 1.0	\$ 670.8	\$ 439.6	\$ (3.3)	\$ (112.3)	\$ 38.1	\$ 1,033.9

See notes to consolidated financial statements

ADESA, Inc.
Consolidated Statements of Cash Flows
(In millions)
(unaudited)

	Six Months Ended June 30,	
	2005	2004
Operating activities		
Net income	\$ 70.9	\$ 61.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19.2	18.1
Bad debt expense	1.1	1.5
Deferred income taxes	2.2	4.0
Compensation associated with equity programs	1.5	0.1
Other non-cash, net	1.2	(0.1)
	96.1	85.5
Changes in operating assets and liabilities:		
Finance receivables	(64.4)	(31.9)
Trade receivables and other assets	(134.3)	(111.3)
Accounts payable and accrued expenses	117.3	140.7
Net cash provided by operating activities	14.7	83.0
Investing activities		
Acquisition of businesses, net of cash acquired	(18.7)	
Purchases of property, equipment and computer software	(36.7)	(5.7)
Purchase of other intangibles	(0.3)	
Proceeds from the sale of property, equipment and computer software	0.1	10.1
Net cash (used by) provided by investing activities	(55.6)	4.4
Financing activities		
Net increase in book overdrafts	52.6	31.2
Net decrease in lines of credit		(45.8)
Payments on long-term debt	(18.5)	(165.4)
Proceeds from long-term debt		400.0
Payments for debt issuance costs		(9.9)
Net proceeds from issuance of common stock		136.0
Issuance of common stock under stock plans	9.1	
Dividends paid to ALLETE		(117.5)
Dividends paid to stockholders	(13.5)	
Repurchase of common stock	(43.4)	
Transfer to restricted cash		(152.4)
Net cash (used by) provided by financing activities	(13.7)	76.2
Effect of exchange rate changes on cash	(0.8)	(1.3)
Net (decrease) increase in cash and cash equivalents	(55.4)	162.3
Cash and cash equivalents at beginning of period	309.4	112.7
Cash and cash equivalents at end of period	\$ 254.0	\$ 275.0
Non-cash activities		
Capital contributions from ALLETE	\$	\$ 1.2

See notes to consolidated financial statements

ADESA, Inc.

Notes to Consolidated Financial Statements

Note 1 Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 footnotes required by generally accepted accounting principles for complete financial statements. Operating results from 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 considered necessary (consisting of normal recurring accruals) for a fair statement of the Company's financial results for the periods presented. 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 the Company's critical accounting estimates is described in the "Critical Accounting Estimates" section of "Management's Discussion and Analysis of Financial Condition and Results of Operations."

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, 2004 included in the Company's Annual Report on Form 10-K (Commission file number 001-32198) filed with the Securities and Exchange Commission (SEC). As used herein, the terms "the Company" and "ADESA" shall mean ADESA, Inc. and its consolidated subsidiaries. The term "ALLETE" shall mean ADESA's former parent, ALLETE, Inc. and its consolidated subsidiaries.

ADESA is the second largest used vehicle auction network in North America, based upon the number of used vehicles passing through auctions annually, and also provides services such as inbound and outbound logistics, reconditioning, vehicle inspection and certification, titling, administrative and salvage recovery services. Through its wholly owned subsidiary Automotive Finance Corporation (AFC), the Company also provides short-term inventory-secured financing, known as floorplan financing, to primarily used vehicle dealers. ADESA is able to serve the diverse and multi-faceted needs of its customers through the wide range of services offered at its facilities.

Certain reclassifications have been made to prior year amounts to conform to current year presentation.

Note 2 New Accounting Standards

ADESA discloses pro forma net income and earnings per share in accordance with Statement of Financial Accounting Standard (SFAS) 123, *Accounting for Stock-Based Compensation* and SFAS 148, *Accounting for Stock-Based Compensation Transition and Disclosure*. In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123(R), *Share-Based Payment*. This statement revises SFAS 123 and supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. SFAS 123(R) requires that the cost of employees services received in exchange for an award of equity instruments be recognized in the income statement. Compensation cost will be measured based on the grant-date fair value of the equity instruments issued. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. No compensation cost is recognized for equity instruments for which employees do not render service.

ADESA, Inc.

Notes to Consolidated Financial Statements (Continued)

In March 2005, the SEC issued Staff Accounting Bulletin 107 (SAB 107), which offers guidance on SFAS 123(R). SAB 107 was issued to assist issuers by simplifying some of the implementation challenges of SFAS 123(R) while enhancing the information that investors receive. Key topics of SAB 107 include discussion on the valuation models available to issuers and guidance on key assumptions used in these valuation models, such as expected volatility and expected term, as well as guidance on accounting for the income tax effects of SFAS 123(R) and disclosure considerations, among other topics.

On April 14, 2005, the SEC approved a new rule for public companies that delayed the effective date of SFAS 123(R) to annual, rather than interim, periods that begin after June 15, 2005. As such, the Company will adopt SFAS 123(R) on January 1, 2006. Once adopted, the Company will be required to record compensation cost as expense for the portion of outstanding unvested awards, based on the grant-date fair value of those awards. The Company expects to apply the prospective transition method of SFAS 123(R), which would allow the Company to prospectively record expense for the compensation costs related to the portion of outstanding unvested awards at January 1, 2006, without restating any prior periods. The Company is currently considering the financial accounting and income tax implications of SFAS 123(R) and SAB 107.

Note 3 Stock-Based Compensation

The Company has adopted the disclosure-only provisions of SFAS 123, as amended by SFAS 148. The Company accounts for stock-based compensation under APB Opinion No. 25, and related interpretations, using the intrinsic value method. Accordingly, the Company has not recognized compensation expense for employee stock options that have been granted.

On February 15, 2005 and April 26, 2005, the Company granted options to purchase approximately 0.7 million shares and approximately 0.1 million shares of ADESA common stock, with exercise prices of \$22.44 per share and \$24.00 per share, respectively, under the ADESA, Inc. 2004 Equity and Incentive Plan. The \$22.44 options vest in equal increments at February 14, 2006, 2007 and 2008. The \$24.00 options vested immediately upon grant. The options have a six year life.

On March 9, 2005, the Board of Directors of the Company accelerated the vesting of certain unvested and out-of-the-money stock options previously awarded to employees and officers that have an exercise price of \$24. The awards accelerated were made under the ADESA, Inc. 2004 Equity and Incentive Plan in conjunction with ADESA's initial public offering (IPO) in June 2004. As a result, options to purchase approximately 2.9 million shares of the Company's common stock became exercisable immediately. The options awarded in conjunction with the IPO to the Company's named executive officers and the majority of the other officers would have vested in equal increments at June 15, 2005, 2006 and 2007. The options awarded to certain other executive officers and employees had different vesting terms. One-third of the options awarded to the other executive officers and employees vested on December 31, 2004. The remaining two-thirds of the options awarded to these executive officers and other employees in conjunction with the IPO would have vested in equal increments at December 31, 2005 and 2006. All of these options expire in June 2010. All other terms and conditions applicable to the outstanding stock option grants remain in effect.

The Company and its Board of Directors considered several factors in determining to accelerate the vesting of these options. Primarily, the acceleration will enhance the comparability of the Company's financial statements in prior and subsequent periods. The options awarded to the executive officers were special, one-time grants in conjunction with the Company's IPO. As such, these grants are not indicative of past grants when ADESA was a subsidiary of ALLETE prior to June 2004 and are not representative of

ADESA, Inc.**Notes to Consolidated Financial Statements (Continued)**

the Company's expected future grants. The Company and Board also believe that the acceleration is in the best interest of the stockholders as it will reduce the Company's reported stock option expense in future periods mitigating the impact SFAS 123(R) that will take effect in the first quarter of 2006.

As a result of the acceleration, the Company disclosed incremental, pro forma stock-based employee compensation expense of approximately \$7.7 million, net of tax, in its first quarter 2005 pro forma disclosure. The acceleration also resulted in a \$2.0 million reduction in the after-tax pro forma stock-based employee compensation expense disclosed in the second quarter of 2005. In addition, the acceleration will result in reductions in the after-tax pro forma stock-based employee compensation expense disclosed in the third and fourth quarters of 2005 of \$1.1 million and \$1.1 million. The Company did not record any stock-based employee compensation expense in the consolidated statements of income associated with the acceleration of these options because the intrinsic value (the excess of the market price of the common stock over the exercise price of option) of the options at the date of acceleration was not greater than of the original intrinsic value of the options. The Company expects that the acceleration will reduce the stock option expense it otherwise would have been required to recognize in its consolidated statements of income in conjunction with adopting SFAS 123(R) by approximately \$4.8 million in 2006 and \$1.2 million in 2007 on a pre-tax basis.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to all stock options. The fair value of stock options was estimated as of the grant date using the Black-Scholes option-pricing model and the attribution method. The Black-Scholes option-pricing model does not consider the non-traded nature of employee stock options, the lack of transferability or a vesting period. If the model took these items into consideration, the resulting estimate for fair value of the stock options could be different. These pro forma amounts may not be representative of the effects on reported net income for future years due to the uncertainty of stock option grant volume and potential changes in assumptions driven by market factors.

	Three Months Ended June 30, 2005		Six Months Ended June 30, 2005	
	2005	2004	2005	2004
<i>(in millions except per share data)</i>				
Reported net income	\$ 35.9	\$ 28.6	\$ 70.9	\$ 61.9
Add: stock-based employee compensation included in reported net income, net of tax (1)	0.5	0.2	0.7	0.4
Deduct: total stock-based employee compensation expense, net of tax	(1.3)	(0.6)	(11.4)	(0.9)
Pro forma net income	\$ 35.1	\$ 28.2	\$ 60.2	\$ 61.4
Earnings per share:				
Basic as reported	\$ 0.40	\$ 0.32	\$ 0.79	\$ 0.69
Basic pro forma	\$ 0.39	\$ 0.31	\$ 0.67	\$ 0.69
Diluted as reported	\$ 0.40	\$ 0.32	\$ 0.78	\$ 0.69
Diluted pro forma	\$ 0.39	\$ 0.31	\$ 0.66	\$ 0.69

(1) Reported amounts include expense associated with restricted stock units and performance share awards.

ADESA, Inc.

Notes to Consolidated Financial Statements (Continued)

The expense noted above for employee stock options granted, determined under SFAS 123, was calculated using the Black-Scholes option pricing model and the following assumptions:

Assumptions	2005	2004
Risk-free interest rate	3.6 %	3.6 %
Expected life years	4	4
Expected volatility	41.0 %	