THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Solera Holdings, Inc. (SLH)

TONY AQUILA is Chairman and CEO of Solera Holdings, Inc., a company he founded in January 2005. As of November 24, 2014, Solera has a $3.6 billion-plus market capitalization, and a mission to bring about a digital evolution of risk and asset management for the automotive and property marketplace, including the P&C insurance industry. Mr. Aquila has a proven track record building manufacturing and software businesses for the global automotive and insurance industries. He is a passionate and successful inventor who holds several patents and was named EY's National Entrepreneur Of The Year in 2013 in the Technology category. He strongly believes that everyone deserves a second chance and created the Solera LIFT — Life Is Full of Transformation — program to integrate into the company's culture an uncommon approach to giving and philanthropy.

SECTOR — MULTIMEDIA SOFTWARE

TWST: Could we begin with a brief overview of Solera's business?

Mr. Aquila: I founded Solera in 2005 to bring about a digital evolution of the insurance industry, starting with the processing of insurance claims. Upon this foundation, we have expanded into mechanical repair and risk-management solutions associated with the asset management of the car and home.

The most important assets the average person owns today are his or her car and home. We had asset managers for our retirement savings and private bankers for our private wealth, but those advisers knew nothing about how to manage these important auto and home assets. What always went through my mind back then was, why? So I felt we could develop software solutions to manage these assets for the public, and we could do it by bringing essential information to everyone involved in the claims process, from the insurance companies and consumers to the OEMs that make cars and the repair shops. That was our mission.

TWST: You started building this expertise in auto claims. What was the process like when you started out?

Mr. Aquila: We started in the collision side of the business because it had a huge amount of pain. It was a nondigital world and a third-party world when it came to painting or repairing a vehicle. So naturally, when you have a policyholder, as the car owner, an insurance carrier and a repair facility, nobody in that circle really trusts anybody else. As a result, they needed a data format and a platform on which all parties could efficiently transact with standardization and trust.

Today, the part of our business centered on insurance claims processing is about 60% of revenue. Most of the other 40% of revenue comes from our mechanical diagnostic and maintenance repair, driver behavior, vehicle history and auto-parts-related businesses. This year, we expect to do around $1.2 billion in revenue, and our mission is to do $2 billion by 2020. Also, we're currently in over 70 countries. We've accomplished this in just nine years.

Starting our company was ambitious, and everybody was telling me, "You're kind of crazy, Tony. This is never going to happen." Of course, as an inventor and an entrepreneur, we often look from the future to the present, rather than from the present to the future, and I think in Solera, we've done both.

TWST: How has the Solera mission evolved along with the evolving technology?

Mr. Aquila: In the beginning, when the software started, I described the software as being 20% of the process and the human as 80%. We developed software in the beginning to automate human steps, and everybody thought that was really cool. If you fast forward into the future, where we are today and across the next five years, software moves to become 80%. So instead of software assisting humans, humans are now assisting software.

This is happening primarily in the area of tasks, such as handling an insurance claim, and assisting with the maintenance and repair needs of your vehicle. No average person knows how to do those things, nor will they ever due to their infrequent nature. So Solera's mission today is to be the 80% intelligence to help you manage the risk of a collision repair, mechanical and maintenance repair and service.

TWST: It sounds like there's tremendous disruption happening in this whole automotive cycle. What's next on that disruptive schedule that could happen? What kind of change do you foresee in the next couple of years?

Mr. Aquila: With the evolution of technology, a car is not just a mechanical platform. The car is becoming more of a safety, infotainment and digital mobility platform. We are also working to manage the digital lifestyle. Today, when you go to sell your car, you have to find the title and other papers. When you do research on the car, you use a combination of the Web and some referrals; you may also visit dealerships and check products like CARFAX.

We believe that, in the future, every one of us will possess a digital garage, and in that digital garage will be your pink slip, your vehicle's history, all your maintenance and your cost of ownership. When you go to sell a car or buy a car, the entire history of the car would be available. Additionally, we expect that you'll be able to get better insurance rates because you can transfer that information so that more accurate underwriting will be available.

TWST: So now we have Google car. What's your view of how that will play out?

Mr. Aquila: Right, so now we have Google car. I'll bet you sometime in the late 1950s or early 1960s, when we had a jet turbine engine in a Chrysler car, everybody was talking about how cars will fly, but the reality is that it just didn't happen. I think there's a disconnect, and a lot of people play off that. We're clearly in a transition period, but nobody can predict the timing of adoption. Everybody can see it once it's inbound, but until it happens, everybody overestimates it.

Right now, there's so much controversy over the anticipation of the autonomous vehicle and whether that will really come to fruition. When you actually look at the number of vehicles that are being sold with autonomous technology, it drops like a rock. I think this line exists that consumers haven't crossed over yet. While in theory they like it and want it, they're just not willing to buy it, yet.

TWST: Have we seen a similar transition in any other industry? Or are we in unchartered waters?

Mr. Aquila: There's a really strange phenomenon going on in this transition period, which I would parallel to the aircraft industry. As you may know, aircraft can fly for many, many years, and they operate with a Six Sigma-type safety record. Now, that's very costly, and you have to spend a lot of money on infrastructure. I understand that industry, as I am also an investor in a leading provider of maintenance repair software for private aviation.

While the reality is that an airplane and a car both carry risk, we have a different risk threshold for cars. For aircraft, you have the optical fear of the plane going down. The risk threshold for cars, however, means that the need for products like ours and the number of repair shops — mechanical, body and glass — will be much higher because we accept more risk when we drive a car.

TWST: What other factors are affecting the vehicle market and the adoption of technology?

Mr. Aquila: There's another shift going on: The average age of a vehicle is increasing at the fastest rate in history. We spent millions of dollars trying to research why these changes were happening, and some of them are counterintuitive to what you see or read about the autonomous vehicle.

TWST: Why is the average age of the vehicle going up?

Mr. Aquila: The average age of vehicles is going up in advanced markets as well as some developing countries. This is happening for a number of reasons, including improved engineering, which requires extensive maintenance; the generational shift; and the growing middle class in developing and emerging markets, which results in more cars being driven more miles by a larger pool of people.

This creates a very interesting phenomenon. The average age of a vehicle in the United States has increased a couple of years, to about 11.4 years. This means there are a billion cars in the world today, and the average age is increasing — we think it will go to 13. The cars entering the market today also have all this new technology, which is more software-based and drive-by-wire, rather than hydraulics or fluids. So you have a scenario where you have counterinfluences happening, where new cars have better technology, but cars also stay on the road longer.

We believe that you can drive this next generation of vehicles much longer. Why? An aircraft can fly for so long because it's maintained with tight tolerances and a focus on safety. It has redundant systems. In the auto industry, they're also building engines that are at the quality level of aircraft and will operate much longer than autos of the past.

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TWST: You mentioned a generational shift. How is this playing out in the industry?

Mr. Aquila: Generations Y and M are the first generations that do not define themselves by the vehicle they drive. They do define themselves by the digital experience they have in everything, which is why we shifted our focus to the household. Insurance, and mechanical repair and maintenance, and all those decisions about managing risk are made at the household level.

In addition, this digital evolution is decreasing our overall mechanical aptitude. More sophisticated software is necessary to diagnose and fix vehicles in a way similar to what occurred with aircraft. Humans are the 20% today in aircraft maintenance, and the software is the 80%. However, the reliance on that 20% is exponential because they're highly trained specialists. We think that type of evolution is going to occur even more broadly across the industrial world.

TWST: Are you selling directly to the consumer? Is that part of your strategy?

Mr. Aquila: No, we actually are not selling to the consumer. We've adopted this philosophy of the customer's customer. Before, we were giving industrial software to experts. But the one thing that is phenomenal about these young people is they are so digitally sophisticated

that they can actually process a claim or research maintenance repair. They can't do any of the repairs themselves, but they can do all the digital activities that used to require people to process for them, whether it be scheduling the car, taking pictures or uploading information.

With all the technologies out there, the consumer can work for the insurance carrier or the mechanical repair shop. This can be coupled with vehicles that have the ability to communicate information up. So now, the most super-sophisticated and efficient generation can do the paperwork. Our mission is for the customer's customer.

In other words, we don't plan to sell directly to the customer, but we plan to deliver the software to our partners, so they can just push it right to their policyholders, right to the customer, and the customer can use it. About 20% of the cost is associated with processing the activity. It'll be built by us, but most likely branded by them. We're aiming to be kind of like the "Intel Inside" guys, if you will.

bringing the digital software to the marketplace so that our customers can deliver our software directly to their customers. This helps remove or greatly reduce the inconvenience of processing activities that humans do. That's a pretty exciting evolution, to make the complicated process much simpler and to let the customers' customer gain transparency because a car is, in some cases, the largest asset they own. They care about it, they want to make sure it's right, and we can provide all that information so that our customer can give it to their customer.

TWST: Can you provide some examples of what Solera currently offers to the mechanical repair process?

Mr. Aquila: A technician needs to have more knowledge at their fingertips, and the only way that is possible now is with software. We currently invest over $100 million a year in software and in developing applications and building databases, including those that help mechanics do the diagnostics of the vehicle through some search indicators.

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TWST: So if we look out the next few years or so, what is the agenda for the company? What's most significant?

Mr. Aquila: The most significant advancements involve geographic expansion, mechanical service and repair, and enabling the digital lifestyle. We plan to expand over the next few years from 73 countries to 100 countries. Those 100 countries between now and the year 2030 will sell 85% of the vehicles on the road. By that time, we estimate that there'll be more than a couple billion cars on the road, and those cars will require service, maintenance and repair.

The mechanical and geographic expansion, and the digital lifestyle of your title and your registration and your drivers' records, we're already doing that. We'll generate a couple hundred million in annual revenue just in those products, and we started with those products in 2009. There is an unknown phenomenon that Solera has invested millions of dollars to figure out: What are the long-term effects of operating a car on a software platform? Let me give you an example.

Let's say you drive a Nissan Altima, an eco-friendly vehicle. It's got some software in it, and it's a very efficient vehicle. Now, what drivers don't know today is what the long-term effects of all the new software components will be, how they'll affect the car. We know mechanical parts and their effects because we've been putting them out from the beginning. Now, the interesting thing about the mechanical side of the car is that if something's wrong, it leaks oil, it rattles, it clicks, it gives you visual and audio indicators. However, when the electronics go out in your car, you've got nothing — no direction or feedback. So we invested a lot of money in the diagnostic part of the equation.

Today, in the U.S., there are more makes and models than there have ever been in history, and that's only a portion of what's about to come when new non-U.S. OEMs introduce their products to the market. So the good news is that mechanical repair will be more consistent, even if there are fewer repair shops. We're excited about that. We plan to invest about $1 billion, and our revenues are growing in the double digits in this category.

On the collision side, it's more about geographic expansion and

If you're a mechanical repair technician, you could key in, "I've got a Mercedes C300, 50,000 miles. I put the key in, I turn it, and the headlights flicker and nothing else." With just the search query, "nonstarting Mercedes C300, 50,000 miles," we can deliver a very high probability of what exactly is wrong with that car, we can instruct you that it's a green wire behind the dash, and we can even tell you how to fix it. That information was never available. Your car would sit there, and the mechanic would charge you for hours.

Today, these mechanics pay us a small transaction fee to access that information. We gained that information just like Google does by getting more users into the system, constantly using their behavioral patterns to develop more and more fixes. We follow up with the individuals, and then we test it, and then we put it in. So the mechanical repair and maintenance side of our business is growing fast, and we're geographically expanding it. That's the future of mechanical repair.

TWST: Can you tell us more about the digital lifestyle and how that works in practice?

Mr. Aquila: With the digital lifestyle, instead of going to the Department of Motor Vehicles and standing in line to get your registration or waiting for the car dealer to do it, we're integrating with the DMV so that we can do that electronically, through a seamless transaction. We have many states where the governments are encouraging the car dealers to use these types of electronic lien and registration systems. Eventually, we think insurers and others will offer that service to the drivers so that they don't have to deal with the long process. There is going to be a great bundling of efficiency for managing the assets of their car and all these decisions about their car.

So we're concentrating on bringing all of that processing technology together for our customers — the insurance carriers, the OEMs, and the mechanical and body shops — so that they can use a system that's fast and highly accurate. Additionally, our system supplies the time that is associated with repairing those items, most of which are standardized, so that nobody has to guess, and hopefully, the consumers

don't get overcharged. The repair times are based on an efficiency method so that it is profitable for a repair shop to do it with our system, and there is a standard in the marketplace.

TWST: Is it part of your strategy to move into other areas other than automotive down the road?

Mr. Aquila: Absolutely. Our strategy is risk and asset management of your car and your home. We process more insurance claims than anyone — about 32 million a year — more than the rest of the claims-processing industry combined. With that kind of foundation, we don't have to reinvent the platform. This is a huge opportunity because Generation Y and M are very fixated on the type of home they have and how to make it more digital.

TWST: Can you give me a time frame for when you could enter this new area of the home?

Mr. Aquila: We're trying to get ahead of the curve because the house will become smart and digital, just like the car, just like the aircraft and so on. The home will be the next place that will require diagnostics. We believe that in the future, the same types of software we built for the car will be usable in your home. Instead of just an alarm system, you'll have a monitoring system. We see a growing interest in services that track activity and then customize to fit the individual's lifestyle.

For example, if your ice machine is acting up, and it's not working, that's a huge cause of nasty water claims. With a small device, we can get a signal when the moisture is changing, and that information could go directly to your insurance carrier, who can then call you up and say, "Hey, we've got to get somebody out to repair that ice machine because we're noticing a change in your moisture." By the way, you'll have gotten that same message on your smartphone. Next, they will just do it electronically.

TWST: Will the car and home be connected?

Mr. Aquila: Right now, we are building a smart house that connects the car, the driver and the home as one big asset-management system. You're going to be able to access the current value of your vehicle. It's even going to tell you when you might want to think about selling it because you will be facing thousands of dollars in mechanical repairs over the next few years, and the depreciated schedule of the vehicle can be calculated. Today, none of that knowledge is readily available to you.

We're assembling a bunch of assets to do that. We've already invested over $2 billion for these assets. We expect to invest another couple billion dollars between now and 2020. I think you will find in the affluent market a kind of home and car integration. It will be sporadic between now and 2020, but by 2030, you will have a more connected world between the auto, the home and the driver, and it will be a very, very big business.

For example, we're experimenting with a car system where your car will know it's you when you drive out your driveway. It will ask you a question, and it will go through a systems check, and it will lock your doors. Keys are no longer necessary. When you have a guest, and you want them to get access to your home, you can text them a message that will give them access. All these things today that we thought of some time ago are now starting to come true.

I mean there are just so many more efficient ways to do things. The Googles of the world will most likely do all those things, but problems will occur with this technology — the maintenance, the service and the claims that nobody will know how to handle. Our vision is for there to be these cool guys in the background called Solera doing that work for everybody.

TWST: What would you say to investors about why this could be a really good time to consider investing in your company?

Mr. Aquila: I think that we've positioned ourselves well to grow and leverage on our core products through geographic distribution. We understand the timing of technology across different geographies and cultures, so that allows us to get tremendous free cash flow. If you look at our profitability, it kind of speaks for itself. I think our adjusted EBITDA margin is about two times that of the S&P 500, and we're investing that profitability in all the things I just talked about. So you can imagine what our profitability would be if we weren't investing in innovation as we are.

Not only are we operating a profitable company today, we have entered markets that are much larger than the core market we started with. We're following the digital world, and taking advantage of being able to process claims and service maintenance and repair activities for our customers' customers. We're developing software that some day could be used for other Big Data analytics applications related to purchase decisions.

We're in all these markets like mechanical repair, electronic diagnostics and our expansion into glass. We're the only one that has this diverse platform, and of course, it's generating huge amounts of data, and we all know what that does in the digital world. It allows our customers to be cognitive of the experience and be very accurate.

TWST: Is there anything that we haven't discussed that you'd like to add to the interview?

Mr. Aquila: I'll just close with this: Today, we have a couple hundred thousand industrial users employing our applications, and in many cases, it is the number-one, go-to tool that they use to communicate and settle and/or diagnose the work they're doing. So it's getting used more frequently than a tool in their toolbox, and that's the impact software is having on the industrial world.

TWST: Thank you. (EP)

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