CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
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5:00 p.m. ET

Operator: Good day, everyone and welcome to the Credit Acceptance Corporation Second Quarter 2017 Earnings Conference Call. Today's call is being recorded. A webcast and transcript of today's earnings call will be made available on Credit Acceptance's website. At this time I would like to turn the call over to Credit Acceptance Senior Vice President and Treasurer, Doug Busk.

Douglas Busk: Thank you. Good afternoon and welcome to the Credit Acceptance Corporation Second Quarter 2017 Earnings Call. As you read our news release posted on the Investor Relations section of our website at creditacceptance.com, and as you listen to this conference call, please recognize that both contain forward-looking statements within the meaning of federal securities law.

These forward-looking statements are subject to a number of risks and uncertainties, many of which are beyond our control, and which could cause actual results to differ materially from such statements. These risks and uncertainties include those spelled out in the Cautionary Statement Regarding Forward-Looking Information included in the news release. Consider all forward-looking statements in light of those and other risks and uncertainties.

Additionally, I should mention that to comply with the SEC's Regulation G, please refer to the Financial Results section of our news release, which provides tables showing how non-GAAP measures reconcile to GAAP measures.

At this time, Brett Roberts, our Chief Executive Officer; Ken Booth, our Chief Financial Officer; and I will take your questions.

Operator: Thank you. Ladies and gentlemen on the phone, if you have a question at this time, please press star and one. If your questions have been answered or you wish to withdraw from the queue please press the pound key.

Our first question comes from Moshe Orenbuch.

Moshe Orenbuch: Hi and thanks. So I guess the first question is I see that somewhat similar to the first quarter, you kind of had somewhat weaker results relative to earlier periods in the 2015 and in this quarter, I guess, relative to three months ago on the '16 and yet kind of able to make that up on the '17 vintage. And I guess maybe talk a little bit about the process that allows for that given the short period of time that you've got the '17 vintage on the books.

Brett Roberts: I think that the clearest number to start with if you're trying to understand loan performance is the net cash flow change for the quarter that's disclosed. So the total net cash flow change was $8.8 million. It's a positive number, but it's obviously a very small one. The total undiscounted cash flows that we're attempting to forecast are somewhere around $5.8 billion. So when you have an $8.8 million move, that's basically flat.

Moshe Orenbuch: Right. And I guess more than all of that is coming from the purchased loans, which have been consistently better than your expectations. When you think about that, is there a risk that, over time, that those show trends that are somewhat less favorable?

Brett Roberts: Again, I think the main takeaway is if you're looking at $5.8 billion in cash flows we're trying to forecast, if you look at the results for this quarter or really over the last six quarters or even longer than that, the cash flows have been remarkably stable. So I think that's a good thing, and that's really the main takeaway.

Moshe Orenbuch: Okay. Just last thing I've got is the 10-Q says that you're informed during June that the CFPB is looking at Equal Credit Opportunity Act and Reg B possible violations. Can you talk a little bit about what the issues that they're looking at are?

Brett Roberts: We don't have a lot to add to what's in the Q. The CFPB is fairly sensitive regarding disclosures of ongoing matters, so we try carefully to walk the line between our obligations to the SEC and to shareholders and the sensitivities of the CFPB. So I won't try improve upon what we put in the Q.

Operator: Our next question comes from John Hecht of Jefferies.

John Hecht: Good afternoon guys and thanks very much. You guys have -- I guess the spreads in the '17 collection curves look a little better than '16. Also, you've written up '17. I'm wondering if there's just any commentary on the competitive markets given the recent market activity.

Brett Roberts: Not a whole a lot of change there. The volume per dealer is the first thing we look at. That was down roughly 5% for the quarter. I think the loan economics may have improved slightly. But given the negative change in volume per dealer, I don't think we're pointing to a large shift in the competitive environment. It continues to be very difficult. It continues to be very challenging.

John Hecht: Okay. Focusing a little bit on expenses. Your salaries -- the salary line and the G&A line have been -- have dropped recently a little bit but have been pretty consistent the last couple of quarters. Are those pretty good base numbers to kind of forecast from? Or is there anything we should think about from a seasonality perspective there?

Brett Roberts: There is a seasonal drop from Q1 to Q2 that I think you'd see if you look back at our numbers over time. But I think the longer-term trend is as long as we can grow the business, we would expect expenses as a percentage of capital or percentage of the book to decline over time.

John Hecht: Okay. And then final question, just that commentary on the sales and marketing side. I know there's been a little bit of renewed push to go sign up some more new dealerships. Do you think that will persist into the second half of the year? Do you guys have an objective in terms of new dealership targets and what that might mean to the sales and marketing line?

Brett Roberts: Yes. We've increased the sales force roughly 20% year-over-year. We expect to increase it a little bit more. During the quarter, new dealer sign-ups were okay; they were better than last year's second quarter, but sequentially we had a decline in active dealers. So I guess the goal, obviously, is to sign up more dealers than we're losing. We didn't do that in Q2, but we hope to do that in the future.

Operator: Our next question comes from John Micenko of SIG.

John Micenko: The prior callers answered most of my questions. But I guess when I think about competition and a few others this quarter have talked about maybe competition easing, it sounds like you're not seeing it to that extent. Do you typically see it more in the number of dealers or the -- an acceleration of dealer growth? Or do you tend to see it more in the volume per dealer when historically competition either ebbs or flows. Is there a rule of thumb that you've seen historically?

Brett Roberts: Yes. From my perspective, volume per dealer is probably the clearest measure. Dealer attrition also tends to follow the competitive environment. We've, I think, historically been pretty successful signing up new dealers, whether it's competitive or not.

John Micenko: Okay. And then you said you added, I think, about 20% to the sales force in the past year. –Is there a lag effect from when a salesperson is on-boarded to when we can see that more meaningfully in the numbers? I mean, I think your dealer numbers were up about 5% on, I guess, a 20% sales force increase. Is there a -- do you look at that and say "Okay, four, six quarters down the road, that number would elevate to a comparable level?" Or is it -- am I looking at that the wrong way?

Brett Roberts: I think there's a significant lag. I think if you look at the last time we increased the sales force, it took us about two years to roughly double the sales force. And so another -- really, almost three years before productivity got to where it was before we started the expansion. So it was overall about a five-year process to double the sales force. We're not trying to double it this time, and hopefully, we've learned a little bit from the first time. But it's still more of a long-term driver than a short-term driver.

Operator: Our next question comes from John Rowan of Janney.

John Rowan: Good afternoon guys, I just wanted to kind of go back to the issue of the dealer partners falling off between 2Q and 1Q. Is there anything seasonal in that number? Or is that just competition causing higher attrition?

Brett Roberts: I think Q2 is a tougher quarter for attrition. You have dealers that come on during tax season and then fall off, so there is some seasonality in that.

John Rowan: Okay. And then there was a relatively big jump in the advance, sequentially, between 1Q and 2Q; it’s up about 4%. It doesn't look like duration is to blame for that. So I was wondering if there was any type of shift in the cars. Obviously, car prices are still weak. So what I'm trying to tee up here is whether or not competitive forces are letting you migrate up and down as far as the age and price of the vehicles or if that's simply just the rotation out of the portfolio loans into the purchased loans?

Douglas Busk: That's certainly some of it. The purchased loans tend to be a little bit larger, have a little bit bigger advance. Also, a little bit newer, more expensive vehicles would be the other part from Q1 to Q2.

John Rowan: So there has been a shift. Is that because of the purchased loans? Or is that just your ability to migrate within competitive advance to get customers buying more expensive car, maybe a better FICO score? Or just give me an idea of what else is driving that higher advance?

Brett Roberts: I think the portfolio loans, from memory, got larger from Q1 to Q2. I think the purchased loans were pretty flat, and then you had a small shift in the distribution toward the larger purchased loans from the smaller portfolio loans. But the average loan size is disclosed in the press release. You can see the advance went up, but the loan size went up by a greater percentage. The overall advance percentage is down '17 versus '16, so it's just a mix issue. We've done those loans before. We're just doing a few more of them. And we price where we see the opportunities, and that shifts the mix around from time to time.

Operator: Our next question comes from Robert Dodd of Raymond James.

Robert Dodd: Hi guys and good afternoon. In the past, you've given us an indication, and we've kind of seen it in the numbers, that when the loan term stretches out a little bit, collectibility tends to drop, just because that longer period if something were to go wrong. That seems to have broken down a little bit. Obviously in '17, it did stretch a little bit from '16, but expected collectibility is up. And the term is materially longer than '15, but now expected collectibility in '17 to '15 is very similar. So are you seeing actual like-for-like improvements in collectibility on same-length loans? Or is there a driver that's really improving that '17 number?

Brett Roberts: I think you're talking about pretty small movements there. I think what we've said is if you take the exact same loan and you stretch out the term, our collection forecast and the results would show that the amount that you're going to collect is going to be less. But that typically isn't what happens. If you do a longer term, you'd typically get a different customer and vehicle mix, and it all boils down to a collection rate which is the one we disclosed.

Robert Dodd: Okay. Got it. Thank you.

Operator: Ladies and gentlemen, if you have a question at this time, please press star then one. Our next question comes from David Scharf of JMP Securities.

David Scharf: Hi guys and thanks for taking my question. First, I just wanted to make sure I heard correctly. Regarding the sales force, did you say the overall headcount is up 20% year-over-year?

Brett Roberts: Yes.

David Scharf: And did I hear you say you anticipate growing that again by 20% into 2018?

Brett Roberts: No. I didn't forecast how much we're going to grow it. I just said we're likely to grow it from here.

David Scharf: Got it. Got it. And along those lines, as I think about the read-through, you had that big doubling, I think, maybe five-plus years ago coming out of the recession, and you were seeing a very competitive market ahead of you. And it sounded like the way to counteract decreases in loans per dealer was to grow the sales force. This seems like another big step function in adding to the sales force. Should we infer anything about what your outlook is for competition easing at all? I'm just trying to get an understanding for strategically, why this new big initiative. Clearly, it's paying off so far.

Brett Roberts: Well, I don't know about that, but I think our outlook is that we're planning on the current difficult environment lasting for the foreseeable future. And if that turns out to be too pessimistic, then that's great. But that's what we're planning for. And so I guess we look at the numbers. We feel like our chances of growing are a lot better if we have a little bit larger sales force, so that's what we're working toward. We had two quarters of negative unit volume change. And this quarter was up, but it was only up 1%. I don't think that the additions to the sales force really added much to that at this point. They're very new. They're still getting up to speed. And I think, again, the increase in the sales force is something that will pay off next year or the year after, probably not this year.

David Scharf: Got it. Got it. Brett, just at a real high level, there are obviously so many metrics that come out each quarter, and we tend to get in the weeds in terms of the vintage analysis. I'm wondering, just looking, for example, the last six-plus quarters, at the end of the day, your net income or your EPS has increased sequentially every quarter. And wondering if you're at all willing to comment that, given everything you know at this point in time, your assessment of the credit environment, what looked like a sequentially flat allowance rate, just a modest uptick in provision, the investment in the sales force, competition, taking everything together, is it reasonable for us to assume that this trend should continue in terms of sequential earnings increases?

Brett Roberts: I think the big variables are how fast we grow and what does loan performance look like. So we've had a couple of quarters where our loan performance has been pretty stable. As you move through the latter part of last year, we had to make some adjustments to our forecast, which had a negative impact on loan volume. So if the forecast continues to be stable, then you just have to figure out what is our growth rate. And your guess is probably as good as mine at this point. We're certainly trying to grow the business. We didn't grow it very fast this quarter, but that's the objective. There is some built-in growth in the balance sheet now because of prior quarters' originations. It doesn't take much to figure out that the balance sheet is still growing, and it will grow for a little while. So as long as everything else stays constant, if the balance sheet grows, earnings will grow as well. But if you're looking out longer than that, it really just depends on your assumptions for unit volume growth.

Operator: Thank you. With no further questions in the queue, I would like to turn the conference back over to Mr. Busk for any additional or closing remarks.

Douglas Busk: We would like to thank everyone for their support and for joining us on our conference call today. If you have any additional follow-up questions, please direct them to our investor relations mailbox at

IR@CreditAcceptance.com. We look forward to talking to you again next quarter. Thank you.

Operator: Once again, this does conclude today's conference. We thank you for your participation.

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