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Q1 2022 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS

Douglas W. Busk *Credit Acceptance Corporation - Chief Treasury Officer*
Kenneth S. Booth *Credit Acceptance Corporation - CEO, President & Director*

CONFERENCE CALL PARTICIPANTS

Arjun Tuteja *Jarislowsky, Fraser Limited*
Moshe Orenbuch *Crédit Suisse AG*
Robert Wildhack *Autonomous Research LLP*
Alexander Villalobos *Jefferies*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation's First Quarter 2022 Earnings 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's Chief Treasury Officer, Doug Busk. Sir, the floor is yours.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation First Quarter 2022 Earnings Call. As you read our news release posted on the Investor Relations section of our website at ir.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 and 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 a table showing how non-GAAP measures reconcile to GAAP measures.

Our results for the quarter include:

Unit and dollar volumes declined 22.1% and 10.5%, respectively, as compared to the first quarter of 2021.

An increase in forecasted collection rates for loans originated in 2016, 2017 and 2019 through 2021, which increased forecasted net cash flows from our loan portfolio by $110 million.

Adjusted net income increased 20% from the first quarter of 2021 to $197 million.

Adjusted earnings per share increased 43% from the first quarter of 2021 to $13.76.

Stock repurchases of approximately 802,000 shares, 5.7% of the shares outstanding at the beginning of the quarter.

At this time, Ken Booth, our Chief Executive Officer; Jay Martin, our Senior Vice President, Finance and Accounting, and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Moshe Orenbuch of Credit Suisse.

Moshe Orenbuch ***Crédit Suisse AG***

Doug, you mentioned the improved cash flows and then there was a note that you also kind of removed the COVID overlay forecast. Can you just talk about -- are those the same thing? Are they different things? And how that runs through the financials. Just help us understand.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Sure. We have a little more detail on page 3 of the release. We did two things during the quarter. One, we felt we had sufficient data since the end of stimulus and the end of enhanced unemployment benefits to basically remove the COVID adjustment from our forecast. Again, our objective is always to forecast future cash flows as accurately as possible, and we felt that the COVID adjustment was no longer necessary.

Additionally, every couple of years, we go through a process where we seek to enhance our forecasting methodology. We did that this quarter, utilizing some additional data and some new forecast variables. The COVID forecast adjustment increased the forecasted net cash flows by about $150 million. The enhanced forecasting methodology decreased it by $54 million, for a total positive change of $96 million. The way that those would flow through our GAAP financials would be a reversal of the provision as indicated on page 3 of the release.

In our adjusted results, those changes would be reflected as a prospective yield adjustment that would impact our finance charges over time.

Moshe Orenbuch ***Crédit Suisse AG***

Great. Is there any way to kind of just flesh out a little more what kind of enhanced methodologies caused that $54 million reduction in future cash flows?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I mean it's -- we don't want to get into too much detail there. It's something we do every couple of years, and we have more recent data to rely on, and we're always looking at new variables that we can incorporate in the forecast. So it just -- it's something that we do periodically. And when you consider we're forecasting $9 billion in forecasted net cash flows, it's not a really big change.

Moshe Orenbuch ***Crédit Suisse AG***

Right. Got it. And when you think about the fact that the kind of expected -- your expected cash flows for loans originated in 2022 are lower. Is that the reason? I mean is it the reason for the decrease that enhanced methodology? Or...

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

No, it really has nothing to do with the new loans. It's just based on the existing loans in the book and what we believe is a better estimate.

Moshe Orenbuch ***Crédit Suisse AG***

Got it. As we think about stock-based comp after the annual meeting, any sense as to the amount we should be adding to the expense line?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

We had about $9 million in stock-based comp this quarter. That was down from about $19 million Q4. On my page 39 of the 10-Q, footnote 14, we have a footnote that shows that we expect to recognize $26.3 million in stock comp over the remainder of the year.

Operator

Our next question comes from Arjun Tuteja, Jarislowsky, Fraser.

Arjun Tuteja ***Jarislowsky, Fraser Limited***

So this question is for Ken. You mentioned in the annual letter that we rolled out a financing program for consumers with higher credit rating. Can you share some more information there; what's our competitive advantage? What are we doing differently? Any information on that program would be helpful.

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

Okay. We're just really -- it's an internal initiative that's designed to capture consumers with just slightly better credit profile. It's something we think we can be profitable at and it makes our product more valuable to the dealers. So it's a way to get more volume. It's been modestly successful so far, we believe; it's about 15% of our volume. So that's all I have to say about it at this point.

Arjun Tuteja ***Jarislowsky, Fraser Limited***

Okay. And are these loans also offered under the portfolio program? Or is it more like purchase loans?

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

They're offered under both programs.

Arjun Tuteja ***Jarislowsky, Fraser Limited***

Okay. Okay. And what's the kind of return on equity or return on assets we are able to generate? Because I mean, the thinking is that as we go upward on the credit spectrum, the competition increases, right? Because there are many players who are trying to kind of get those loans because those are lower risk. So are we able to get the high profitability, which we usually make from our legacy loans?

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

We don't really talk about pricing and how much we're going to make on various programs. I will say our overall goal is to maximize the economic profit in the long run. And we feel like this program is consistent with that objective.

Operator

(Operator Instructions) Our next question comes from Rob Wildhack of Autonomous Research.

Robert Wildhack ***Autonomous Research LLP***

I wanted to ask you about the unit originations in the quarter. Based on where January was and where the quarter finished, it seems like there was some notable improvement in February and March. Can you talk about what was driving that improvement?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Well, as we pointed out in our Q1 release, we had a tough comp versus January of last year due to federal stimulus dollars. Comparing the rest of the quarter, it was a little bit difficult. February was very good, but I think there's differences in the timing of tax season. And then in March, we had another tough comp due to stimulus dollars last year. I think a relevant data point is we point out in April that volumes are tracking better, down about 14%. And that the trend in April was encouraging. So there's a long-winded answer; there's a bit of noise in the quarter. So I think the April data point is a relevant one.

Robert Wildhack ***Autonomous Research LLP***

Okay. And then last time we spoke, I think the message, or I thought the message was, that the buyback probably wouldn't be able to continue at the pace it had in the later quarters of 2021 but this quarter with 800,000 shares repurchased was strong again. So can you just talk about what went into that and what your outlook is for any future buybacks?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

We continue to think about buybacks the same way. We would prefer to invest our capital in new loan originations because we think that's what's best for shareholders. But if we can't deploy our capital in loan originations at returns that we're happy with, and we can buy the stock at an attractive price, that's what we do. I think that last quarter, I was asked about, as our leverage increase, what that means for future stock repurchases. And I think you can look back and see that historically, when we're lowly leveraged, all things equal, we tend to buy more shares. And when we're more highly leveraged, we tend to purchase fewer shares. And we're at the higher end of the historical range today. So you can draw your conclusions from that.

Operator

(Operator Instructions) And next, we have Alexander Villalobos of Jefferies.

Alexander Villalobos ***Jefferies***

Perfect. I did want to ask a little bit more about write-offs and recoveries, maybe like dollar amounts and how these performed versus prior quarters?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I think the best way to think about credit quality is just looking at the table on page 2 of the release, that compares our initial forecast to our most recent forecast. And you can see for the last 10 years, on average, we've been pretty close, but we have four years that have underperformed our initial expectations, and the remainder have performed better than our initial expectations. I think that's the simplest lens through which to view credit quality.

If you look at the rollforward of loans receivable, the adoption of CECL has had a significant impact on the way we provision and the amount of write-offs that will occur. And under CECL, our write-offs are going to be higher than we were historically, either because we have the gross asset on the balance sheet that includes amounts we never expected to collect or because we're recognizing revenue with the contractual yield as opposed to the yield we expect to earn.

So drawing conclusions about credit quality by looking at the write-offs post adopting CECL, it's tough to draw any clear conclusions there. So I'd just direct you to the table that I mentioned.

Operator

And we have a follow-up question from Rob Wildhack of Autonomous Research.

Robert Wildhack ***Autonomous Research LLP***

Ken, I wanted to ask you about the shareholder letter. I thought there was a big emphasis on technology going forward. Can you talk in a little more detail about the kinds of improvements you want to make, what those might do in terms of expenses or the investment required, and what kind of benefit you think you'll ultimately receive from them?

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

Yes. I mean obviously, the business model has changed over the years, where technology is becoming more and more prevalent. We've hired, as you might have saw in an announcement, we've hired a Chief Marketing and Product Officer, who hopefully will help lead our efforts and be a little innovative in making our product even more valuable to our dealers.

So we're continually looking for ways to improve the business. But really, as we invest in technology, it's hard to say what we're going to spend on it, but we expect to get a return on it. So it's really just an investment in our future. But I don't really have hard data I want to share. I don't know how that's going to play out. But the belief is the more valuable we can make the product to the dealer, ultimately, the better business we make for ourselves and for the shareholders.

Operator

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 W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

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, and have a nice day.