# CREDIT ACCEPTANCE CORPORATION

## Moderator: Douglas Busk
## July 30, 2019
## 5:00 p.m. ET

**Operator**

Good day, everyone, and welcome to the Credit Acceptance Corporation Second Quarter 2019 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 ti me, I would like to turn the call over to Credit Acceptance's Senior Vice President and Treasurer, Doug Busk.

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**Douglas Busk** – *Credit Acceptance Corporation*

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Second Quarter 2019 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 o ur 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 questi ons.

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**Operator**

Thank you. Ladies and Gentleman, if you have a question at this time, please press star and then one on your touchtone telephone. Our first question comes from Moshe Orenbuch of Credit Suisse. Your line is now open.

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**Moshe Orenbuch** – *Credit Suisse*

So Doug, we noticed that you added some expanded discussion of CECL, and you talked about that you're going to elect CECL as opposed to fair value. Could you talk a little bit about the thought process that went into that?

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**Douglas Busk** – *Credit Acceptance Corporation*

We were faced with two accounting alternatives that, in our opinion, did a worse job reflecting the underlying economics of our loans than our current method does. We elected CECL for a few different reasons. One of which is because we wanted to minimize t he volatility in our financial results that would occur under fair value in a period of changing interest rates. That volatility could have a material impact on our financial results and financial condition. CECL has less volatility relative to market-based interest rates, so that was one consideration. Additionally, we've modified our revolving credit facilities, so that the amount we're going to be able to bor row and our ability to comply with the covenants is going to be unaffected. We expect to be able to do the same with our term ABS financing. And then the final thing is, as we said in the Q, we believe we're going to be able to explain to shareholders how CECL diverges from economic reality. So really, that was the thought process.

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**Moshe Orenbuch** – *Credit Suisse*

So I guess, if you've done that work, can you share with us your results? I assume that means you're probably running in parallel. Can you share with us what the results would look like under CECL?

**Douglas Busk** – *Credit Acceptance Corporation*

We're not prepared to quantify the impact of CECL at this point. We expect to provide incremental disclosure in Q3 of this ye ar.

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**Moshe Orenbuch** – *Credit Suisse*

Got you. We noted that you hadn't done a securitization since back in February. You mentioned that you'll be able to in the future kind of restructure them. What should we expect from a funding standpoint?

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**Douglas Busk** – *Credit Acceptance Corporation*

The reason we didn't do a securitization this quarter really doesn't have anything to do with CECL. We have already done a securitization and a senior note issuance this year, so we've accomplished quite a bit from a capital -raising perspective. We don't think that the adoption of CECL is going to have a material impact on the structure of the securitizations .

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**Moshe Orenbuch** – *Credit Suisse*

Okay. Then just lastly, the commitments footnote does mention a New York State AG subpoena. That was issued, I guess, 2.5 months ago. Is there anything that you can add to what's in there?

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**Douglas Busk** – *Credit Acceptance Corporation*

Nothing really other than what's disclosed in the Q.

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**Operator**

Our next question comes from David Scharf of JMP Securities. Your line is now open.

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**David Scharf** – *JMP Securities*

First question, Doug, focusing on leverage. And I actually could just as well have been asking this question every quarter, b ut given the pullback in rates and reduced funding costs, I figured it becomes more and more topical. Obviously, your ROEs are quite high. You're certainly under no pressure to expand them. But at 2x debt to equity, certainly in comparison to some other public auto lende rs and subprime lenders, you're comparatively under levered. Is there any thought to levering up beyond sort of the current range that we've been seeing recently of about 2x?

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**Douglas Busk** – *Credit Acceptance*

The range over the last five years or so has been between 2 and 2.5:1. So we're at the low end of the historical range. The reason we operate with the leverage that we do is we want to be able to produce strong results and originate a reasonable amount of business if the capital markets are unavailable to us for an extended period of time. So that's the rationale behind employing the levera ge that we do.

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**David Scharf** – *JMP Securities*

Yes. Okay. So we should interpret that as you're certainly not seeing anything materially different in the business fundament als that would lead you to lever up further. One question, just on pricing directionally. When I just do a simple average calculati on, which is take average beginning and ending balances for the quarter, divided into the finance charges, come up with an average yield, I thi nk, 21.8, which is the same as Q1. Obviously, a lot goes into that IRR calculation, forecasted losses as well. Bu t at a high level, is it fair to assume that your average pricing on new originations hasn't changed materially over the last three months?

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**Brett Roberts** – *Credit Acceptance Corporation*

Yes, nothing's changed from a pricing perspective.

**David Scharf** – *JMP Securities*

Okay. Got it. And then last question, following up on Moshe. This is not meant to be a got-you question. I think it may just be pure coincidence. In the disclosure, the New York State subpoena is May 7, and the New York State DFS actually dropped their investigation just two weeks before that. CFPB had another CID just a couple of days before that. Mississippi decided to pursue a suit. Looked like there were four actions within just 15 days. Is that pure coincidence? Or is there a sense that there is maybe an acceleration of the activity in other states that may come to the surface?

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**Brett Roberts** – *Credit Acceptance Corporation*

No. We don't have any insight into when and why those things get started. If it's coincidence, if it's not—we don't have any insight into that.

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**Operator**

Our next question comes from Hugh Miller of Buckingham.

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**Hugh Miller** – *Buckingham*

So I was taking a look at the loan volume per dealer being down maybe about 9% year-over-year. Seems like you guys were increasing the advance rates a little bit, or giving more of an incentive to do business. What's the feedback that you're hearing from dealers just about their sensitivity around advance rates and what they may need to see to maybe do a bit more business?

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**Brett Roberts** – *Credit Acceptance Corporation*

I don't think we get much insight from dealers on the pricing. The change in volume per dealer—it's big for us, but for an individual dealer, it's not enough that they would notice. We've had periods before where volume per dealer has come back down, and we're in one of those periods where it's tough right now. The positive for the quarter was we were able to grow the active dealer base. So as long as we can continue to do that, volume per dealer at some point will level out.

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**Hugh Miller** – *Buckingham*

And is there a strategy—I know you guys did some hiring activity— just to kind of incentivize the sales force to try and drum up more business with the dealers, or is that not as much of a focus?

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**Brett Roberts** – *Credit Acceptance Corporation*

We've expanded the sales force. They have lots of incentives to grow the business in their markets. Many of them are having success. We were flat for the quarter, so as you might expect, roughly half the markets were growing, and half the markets were doing the opposite. And the net effect was not much growth for the quarter, but I don't think it has anything to do with sales force incentives.

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**Hugh Miller** – *Buckingham*

Got it. That's helpful, thank you. And then just as we look at the allowance for credit losses, we track that relative to the gross loan portfolio. It has been trending a bit lower. But as we think about that in the context of seeing a mix shift towards more purchased loans, which don't offer some of the dealer participation protection. How should we think about that ratio and the relationship there? And at some point, is there kind of a minimum threshold on that allowance relative to the loans that we should consider? Or how should that trend, I guess?

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**Brett Roberts** – *Credit Acceptance Corporation*

The way we think about it, and I guess, the way we would recommend that others think about it is to focus on the adjusted results. And then you don't have to worry about the allowance ratios or why the provision went up this quarter. You can adjust the results, really simplify the financials in light of focus on what's important.

**Hugh Miller** – *Buckingham*

Got you. Okay. And then just last for me, as we think about just the trend in the purchased loans and the yields maybe dipping below the 20% threshold, can you just talk a bit about how you think about issuing or putting capital to work in purchased loans relative to maybe considering more of a stock buyback given how strong your ROE is?

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**Douglas Busk** – *Credit Acceptance Corporation*

As we've said many times, we prefer the portfolio program because of the alignment of interests and the way it shares the risk on the loans with the dealers. Having said that, we're generally in a position where we have more capital than what we can invest in the portfolio program for returns that we're happy with. So we think investing in purchased loans at returns that we're happy with is a better use of our capital than buybacks.

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**Operator**

Our next question comes from Giuliano Bologna of BTIG. Your line is open.

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**Giuliano Bologna** – *BTIG*

One of the things I was trying to figure out, back into some of the numbers, is that it looks like the average loan size on the purchase program seems to increase significantly; kind of in the high teens sequentially. Is there any change there? Or is the term higher on some of the purchased loans in the quarter that's maybe driving that? Just trying to figure out what the driver might be there.

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**Brett Roberts** – *Credit Acceptance Corporation*

You see a correlation between term and the size of the loan, so that's probably the case. Just the change in mix. We're not writing any loans that we haven't written before. We're just writing a different mix than we did in the prior period.

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**Giuliano Bologna** – *BTIG*

Do you know if there's any sense of the duration or is the duration extended more so on the purchased loan side? Because that may explain, if you increased a few months on the purchase side versus the dealer program.

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**Douglas Busk** – *Credit Acceptance Corporation*

I don't think there's been a material difference.

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**Operator**

Our next question comes from Dominick Gabriele of Oppenheimer. Your line is open.

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**Dominick Gabriele** – *Oppenheimer*

When we think about the year-over-year average gross loan receivables and the movement there, can you just walk us through how your unit volume and the active dealer growth all translate eventually to the gross loan receivables?

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**Brett Roberts** – *Credit Acceptance Corporation*

Over a long period of time, the gross receivable will grow at the same rate as your origination growth. But obviously, there's a big lag between one and the other. So we were flat this quarter from a unit respective. We had some growth from a dollar perspective. If that growth is consistent, over the next two years, your loan receivable growth will decelerate until it reaches that point. So the balance sheet is growing based on prior periods' origination growth. And because the origination growth was slower this quarter and last quarter, we would expect the balance sheet growth to decelerate.

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**Dominick Gabriele** – *Oppenheimer*

And then when we think about the G&A expense; may seem a little picky. I'm just looking at the G&A expense, and it's a bit elevated from what we've seen in the last few quarters. Is there something going on there? Should we think about a higher elevated run rate going forward than what we've seen in the last few quarters? Or is this kind of a just one-off something was in there?

**Douglas Busk** – *Credit Acceptance Corporation*

I think it's impossible to tell. We disclosed the reasons for the elevated level of G&A in the press release and the 10-Q. But I'm not going to make a prediction as to what level that expense will be at in future periods.

**Dominick Gabriele** – *Oppenheimer*

Okay. Great. And then you have seen the collections, actually, on both dealer and purchased loans for the 2018, '19 vintages come in better this quarter than your initial estimates. Can you just talk about what you're seeing and why your expectations have risen for collections in those two vintages in particular?

**Brett Roberts** – *Credit Acceptance Corporation*

I think if you look at it over a long period of time, the forecast have been pretty accurate over a 21-year period for which we've now published forecast results. You got roughly an even split between years where we've been optimistic and years we've been pessimistic. We've got a few more favorable results than unfavorable, but there's going to be a variance from period to period. This quarter, in total, if you look at the variance, the best number to focus on is the dollar amount of the change in the forecast during the quarter, $13 million; pretty small number. So I think a fair conclusion to draw is the forecast was pretty stable this period.

**Dominick Gabriele** – *Oppenheimer*

Okay. Got it. Can you just talk about what may be driving your price per unit paid, in particular, that's helping the dollar volumes over the unit volumes in a little more detail?

**Douglas Busk** – *Credit Acceptance Corporation*

You mean the dollar amount of the advance—the amount paid to the dealer at origination?

**Dominick Gabriele** – *Oppenheimer*

Yes. Exactly.

**Brett Roberts** – *Credit Acceptance*

Again, just a mix issue, so we're not doing any loans we haven't done before. It's just the different mix we saw this quarter than last quarter.

**Operator**

Thank you. And with no further questions in queue. I would now like to turn the conference back over to Mr. Busk for any additional or closing remarks.

**Douglas Busk** – *Credit Acceptance Corporation*

We'd 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.