EDITED TRANSCRIPT

Q4 2021 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS:

Kenneth S. Booth; *CEO, President & Director*
Douglas W. Busk; *Chief Treasury Officer*
Jay D. Martin; *Senior Vice President – Finance & Accounting*

CONFERENCE CALL PARTICIPANTS:

Moshe Orenbuch; *Credit Suisse AG*
David Scharf; *JMP Securities LLC*
Rob Wildhack; *Autonomous Research LLP*
John Hecht; *Jefferies LLC*
John Rowan; *Janney Montgomery Scott LLC*
Vincent Caintic; *Stephens Inc.*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation Fourth Quarter 2021 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 Chief Treasury Officer, Doug Busk.

Douglas W. Busk; *Credit Acceptance Corporation*

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Fourth Quarter 2021 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, 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.

Our results for the quarter include:

- Unit and dollar volumes declined 22.6% and 12.7%, respectively, compared to the fourth quarter of 2020.
- An increase in forecasted collection rates for loans originated in 2019 and 2020. This resulted in a $31.9 million increase in the forecasted net cash flows from our loan portfolio.
- Adjusted net income increased 12% from the fourth quarter of 2020 to $212.6 million.
- Adjusted earnings per share increased 33% from the fourth quarter of 2020 to $14.26.
- Stock repurchases of approximately 606,000 shares, 4.1% 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 & Accounting; and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question coming from the line of Moshe Orenbuch with Credit Suisse.

Moshe Orenbuch; *Credit Suisse AG*

Great. A couple of things, I guess. First off, in the release, you talked about the January volumes as being down 36.6%—I'm sorry, it's down 36.8%—but you also mentioned that January 2021 was particularly strong. How should we think about that commentary? Was that just in January? Was that the rest of the quarter? Can you talk about that a little bit?

Douglas W. Busk; *Credit Acceptance Corporation*

January, in a relative sense, was a pretty strong month last year. I think we were down 6% for the month of January versus the January of the prior year. The quarter was not that strong, but still better than the quarters we've experienced recently. And again, I believe that the strength in January of last year was due to stimulus.

Moshe Orenbuch; *Credit Suisse AG*

Got it. Okay. And you mentioned the $31.9 million of write-ups on the 2019 and 2020 [loans]. As I look here, it says that there's a 0.3% reduction in your expected cash flows for the loans originated most recently.

Douglas W. Busk; *Credit Acceptance Corporation*

Yes. Typically, if you look at the most recent quarter disclosed, there will be a decline from our initial estimate. As you point out, in the fourth quarter of this year, the decline was 0.3%. A lot of that is just due to the fact that we don't remove canceled consumer loans from the denominator in calculating the ratio. That's disclosed in footnote 1 to the table on page 2.

Generally, the loan cancels occur early in the life of the loan. And then after that, what has historically happened is the loans outperform and that becomes a positive number. That's what has happened historically. Whether that will be the case in Q4, we'll have to see.

Moshe Orenbuch; *Credit Suisse AG*

Got it. And then you mentioned the 600,000 and change shares that you repurchased. Could you talk a little bit about how you're looking at your leverage and what that might mean for your ability to buy back shares in the future?

Douglas W. Busk; *Credit Acceptance Corporation*

We're continuing to think about stock buybacks the same way we have in the past. I want to make sure we have ample liquidity. If we have ample liquidity, then I believe that purchasing shares is a good use of shareholders' money. We'll continue to invest in stock repurchases.

Relative to financial leverage, historically, we've repurchased more stock when we're lowly leveraged than when we're highly leveraged. So, I would expect that stock repurchases perhaps may not be as strong in the next couple of quarters as they were in the last half of this past year.

Operator

Our next question coming from David Scharf with JMP Securities.

David Scharf; *JMP Securities LLC*

Maybe kind of difficult to pinpoint, but as we just think about the volume pressures on the entire industry as well as yours specifically, driven by these excessive used car prices, sort of wondering, is there any sort of metric or percentage decline in benchmarks like the Manheim or an ADA index? Is there any sort of figure that we could potentially look to that would signal a turnaround in consumer demand in your mind?

For example, I'm looking six quarters back, your average contract size was 11% lower than it is now. And I'm just wondering if there's sort of, if not a silver bullet, is there a decline in the Manheim or decline in average used car prices from today's level that you would feel comfortable would probably be signaling a turnaround to positive year-over-year growth in unit volume for both you and the industry?

Douglas W. Busk; *Credit Acceptance Corporation*

No, I don't think you can say that there's a magic number out there with the Manheim or any other used car index. I think if used car prices remain stable or increase, that's a bad thing from a volume perspective, and if used car prices decline, I think that's a positive. And the more they decline, the better. But there's no magic number. There's no cliff when magically things go back to normal. I think it's just gradual.

David Scharf; *JMP Securities LLC*

Right. Right. Yes. No, clearly, directionally, we're kind of waiting for that turnaround. Just to venture into your crystal ball, do you have any commentary you're able to provide on your outlook for used car volumes, independent dealer health and deep subprime demand throughout 2022?

Douglas W. Busk; *Credit Acceptance Corporation*

I don't think that we have any unique insight there. I think your guess is as good as ours, David.

Operator

Our next question coming from the line of Rob Wildhack with Autonomous Research.

Rob Wildhack; *Autonomous Research LLP*

Can you just highlight or update us on what you're seeing competitively in the market?

Kenneth S. Booth; *Credit Acceptance Corporation*

Obviously, you can see our volumes are down. If you think about our marketplace, I think a good way to look at it is looking at our volume per dealer. There's industry data that shows subprime is down. That would be my overall thought; volume per dealer kind of shows the strength of the competitive market.

Douglas W. Busk; *Credit Acceptance Corporation*

When I think historically, any time the industry has had access to lots of capital and the cost of that capital is cheap, it…
(technical difficulty)

Operator

This is the operator. I'm showing the speaker lines got disconnected. We'll give it a moment until they reconnect. Please stand by.

Operator

Yes, Speakers, you're now back live.

Douglas W. Busk; *Credit Acceptance Corporation*

This is Doug Busk. We were disconnected there. I'm not sure if my last response was completely heard or not, but I apologize for that.

Rob Wildhack; *Autonomous Research LLP*

Doug, this is Rob. Can you hear me? I'm not sure if I'm live either.

Douglas W. Busk; *Credit Acceptance Corporation*

Yes, I can hear you.

Rob Wildhack; *Autonomous Research LLP*

Okay. Great. You cut off right around you were going into—when competitors have lots of access to capital and the cost of capital is cheap, and then it—that's when it dropped off.

Douglas W. Busk; *Credit Acceptance Corporation*

Okay. Thanks for refreshing me. Generally, when those conditions exist, the marketplace tends to be pretty competitive, and the current environment is no exception. There's lots of companies out there with access to lots of capital at very low cost.

Rob Wildhack; *Autonomous Research LLP*

Got it. And then maybe to stick with that comment. I mean do you think that a rise in interest rates here through 2022 would be enough to dent competition? Or do you need prevailing interest rates to be considerably higher than they are right now?

Douglas W. Busk; *Credit Acceptance Corporation*

I think it's kind of like the used car price question. Every little bit helps, but I think they would have to be substantially higher to have a meaningful impact.

Rob Wildhack; *Autonomous Research LLP*

Got it. And if I could ask one more on the consumer side. I was just wondering if you could comment a bit on the potential impact that inflation could have on consumers' ability to repay. Inflation running as high as it was, does that factor into your expected collections in any way?

Douglas W. Busk; *Credit Acceptance Corporation*

No, it doesn't. We base our forecasted collections on how loans with similar attributes have performed historically. We don't have a macroeconomic component that we overlay on that. So, if we have a period of significantly higher-than-normal inflation, that has the potential to impact customers' ability to pay.

Operator

Our next question coming from the line of John Hecht with Jefferies.

John Hecht; *Jefferies LLC*

Thinking about volume, you touched on pricing and competition, but how much of your volume is impacted by just low overall inventory levels and other industry factors?

Kenneth S. Booth; *Credit Acceptance Corporation*

I think that's a significant thing that's impacting us right now. I think, honestly, the last couple of questioners have asked about when there might be a turnaround. I think the most likely time there'll be a turnaround for volume for us will be when vehicles are more readily available and prices stabilize and maybe go back to normal where they become a depreciating asset.

John Hecht; *Jefferies LLC*

I mean do you have any thoughts for… based on what you're hearing from industry sources, whether it's off-lease supply or some fleet sales or repossessions, any sense for when that might start to occur?

Kenneth S. Booth; *Credit Acceptance Corporation*

We've spent a lot of time scouring information sources to learn about that, but I'll be honest, I think there's a wide range of possibilities there. I've seen reasonable sources predict to be later this year, and I've seen reasonable sources say it won't be until early 2024. So, I think there's a lot of uncertainty related to the downstream impact of the pandemic and until cars are available, we're not really sure when that will be, but we still view it in the grand scheme of things as a temporary situation, not a permanent one.

John Hecht; *Jefferies LLC*

Okay. And then, obviously, your yields benefited this quarter from strong performance. And obviously, you may have strong performance all the time and you may not. But like excluding the incrementally strong performance of some of the recent vintages, what do you guys think the yield on your... what's the right yield on your portfolio as things normalize?

Douglas W. Busk; *Credit Acceptance Corporation*

Are you talking about the GAAP yield or the adjusted yield?

John Hecht; *Jefferies LLC*

Yes, correct. Yes, just the GAAP yield, which is effectively finance charges divided by the average loan balance

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Douglas W. Busk; *Credit Acceptance Corporation*

The GAAP yield is based off of contractual cash flows, which we know we're never going to make that yield, so we don't spend a lot of time focusing on it. But I think the GAAP yield we're reflecting today is pretty close to the contractual yield on loans we're writing today. But again, because of CECL and the fact that our GAAP yield is based on contractual cash flows, we don't spend a lot of time focusing on that.

Operator

Our next question coming from the line of John Rowan with Janney Montgomery.

John Rowan; *Janney Montgomery Scott LLC*

Doug, you talked a lot about car prices impacting volume. I'm wondering what, if any, impact there was in the duration reduction in the fourth quarter from a volume perspective and whether or not you were at 58 months again in January or if there was another duration cut in January affecting that year-over-year performance?

Douglas W. Busk; *Credit Acceptance Corporation*

I don't know what the duration is going to be in January. The reduction from 59 to 58, again, just a function of car prices and affordability issues for consumers. I would expect that that probably continued in January, but I don't know for sure.

John Rowan; *Janney Montgomery Scott LLC*

Okay. And then just lastly for me. I think there was a relatively big increase in other income. Was there anything one-time in nature in there? Or what was driving that $18.3 million other income line?

Jay Martin; *Credit Acceptance Corporation*

Yes, it's primarily related to our ancillary product profit sharing. A lot of that is driven by claims rates. We did see lower claims rates in the fourth quarter. It's been volatile historically. So, it's not necessarily a permanent change. I think it's just normal volatility within the profit sharing.

Operator

(Operator Instructions) And our next question coming from the line of Vincent Caintic with Stephens.

Vincent Caintic; *Stephens Inc*

Just two quick ones. So, one is a follow-up. That other income line with the increase in ancillary profit sharing, is that something that because credit is better, we should expect to continue? Or is that sort of a one-time true-up for this quarter?

Jay Martin; *Credit Acceptance Corporation*

It's not related to credit. It's not necessarily a one-time true-up. It's just how claims rates have come in. It's primarily related to our GAP product. So, I would say, I do think we were helped out with some higher vehicle prices there, probably had some impact on claims rates. But historically, we've seen a fair amount of fluctuation in our claims rates over time. So, I would just consider it to be normal volatility.

Vincent Caintic; *Stephens Inc*

Okay. Got you. And then the second one, just on expenses. So just wondering how to think about that going forward. So, the salaries and wages, that was up 46% year-over-year, but your G&A expense was down 11%. Just how to kind of think about how you're managing expenses going forward?

Douglas W. Busk; *Credit Acceptance Corporation*

Well, a lot of the increase in the expenses—as we point out in the release—just related to stock compensation expense relating to stock options that were granted to the executive team as part of a new pay plan. That's really what's driving the vast majority of the increase in expense in the last couple of quarters.

Vincent Caintic; *Stephens Inc*

Okay. Got it. So, I guess that would be salary and wages, but the G&A, on the other hand, went down. So that was nice that the G&A expense went down. Just wondering what we should be expecting going forward in terms of efficiency.

Douglas W. Busk; *Credit Acceptance Corporation*

I mean big picture, our expenses as a percent of revenue or expenses as a percent of average capital have declined over the long term as we've grown the business because we benefited from operating leverage. As we're in this period, where we're not growing and average capital will perhaps be declining, I think it's logical to assume that our operating leverage would be under pressure and could go the other way. The degree to which it does so will just depend on what happens from a growth perspective.

Operator

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

Douglas W. 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

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.