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Q4 2022 Credit Acceptance Corp Earnings Call

EVENT DATE/TIME: JANUARY 31, 2023 / 10:00PM GMT

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Shanna Qiu *Bank of America*
Christopher Ryan *Radcliffe Capital - Senior Analyst*

PRESENTATION

Operator

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

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

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Fourth 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, 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 GAAP and adjusted results for the quarter include:

Unit and dollar volumes grew 25.6% and 26.2%, respectively, as compared to the fourth quarter of 2021.

A decrease in forecasted collection rates for loans originated in 2021 and 2022, which decreased forecasted net cash flows from our loan portfolio by $41 million, or 0.5%.

Adjusted net income decreased 26.6% from the fourth quarter of 2021 to $156 million.

Adjusted earnings per share decreased 17.7% from the fourth quarter of 2021 to $11.74.

Stock repurchases of approximately 208,000 shares, which represented 1.6% 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) The first question I have is coming from Moshe Orenbuch of Credit Suisse.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

I'm hoping you could give us a little bit of help understanding. You've had several quarters of write-ups of your cash flow expectations. The last three, have been down in the mid-40s, 80s and now 41 again. How do we think about where you're sitting in this process, and how should we think about how that affects the yield on the adjusted earnings basis?

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

We update our forecast based on loan performance and how loans with the same attributes have performed historically. So what we've seen, I believe, for the last three quarters, is that loan performance was actually a little bit worse than expected at the end of the preceding quarter. That has caused our forecast of future net cash flows to decline a little bit. So where we're at= is its impossible to say what happens to our forecasted collections, and, therefore, the adjusted yield on our portfolio is really dependent on how loan performance is in the future.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Right. And I don't think you gave any update in the release for January or anything like that, right?

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

We did not. We have volume in there for the first 28 days of the month, but we don't have anything loan performance oriented.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

And then, Doug, the other element is that the level of originations you just mentioned was up a little bit in January in units but was kind of flattish to slightly down a little bit in terms of where it was in the fourth quarter. And the spreads don't look like they got any better. Can you kind of characterize for us the competitive environment? I think there are some people that would have expected by now to see that competitive balance shift away from some other originators. So what are you seeing, and can you kind of talk about that a little bit?

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

I think we had a strong fourth quarter from an origination perspective, and through the first 28 days of January, we had strong originations as well. So I think that the numbers we put up from an origination perspective, really the third and fourth quarter and thus far in January indicate that the competitive environment has improved.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Got you. And the spreads that you're able to achieve was the difference between what you forecasted collections and what you pay for the loans?

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

We modified a table in the press release this quarter to show you what the spread was based on the initial forecast and what the spread is as of December 31, 2022. And really since 2017,the initial spread has been approximately 20%. The variability you've seen there has been primarily due to loan performance being different than expected. In '19 and '20, loan performance was better than expected. That had a positive impact on the spread. And then in 2022, with loan performance, thus far being worse than expected, that put a bit of pressure on the spread.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

And then just a...

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

Initial spread in Q4 was certainly better than it was in the first three quarters of the year. But that's a relatively unseasoned book of business. We'll just have to see what happens to loan performance.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Got it. Then last one for me. In the first three quarters of every year, you filed a 10-Q along with the earnings release. Obviously, in the fourth quarter, the 10-K takes a little while longer. Given all the activity this quarter, any chance that we'll get an update on the legal and regulatory situation before the 10-K is out?

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

I can talk a little bit about it right now. We generally don't comment on active litigation, but I'll say we disagree with the allegations in the complaint. We intend to strongly defend ourselves in the pending lawsuit. There was a time when the regulatory expectations were more clear and enforcement was for companies that didn't take compliance seriously. Now this lawsuit, in my opinion, reflects a different approach.

As a company, we strive to comply with the extensive framework of laws and regulations that govern our industry and we work hard to do what is right. When you think about our industry, we provide financing options to dealers nationwide that enable dealers to offer opportunities to millions of consumers who are credit impaired and credit invisible. Approximately 30% of all consumers, which is 67 million adults, have credit scores below of 670, which is credit impaired. There's millions more that are credit invisible. If the allegations in the lawsuit are credited, there would be a significant impact on the finance industry and all these consumers across the country.

So we'll be addressing that with the court during the course of litigation. But again, we disagree with the allegations, and we intend to vigorously defend ourselves.

Operator

(Operator Instructions) And our next question will be coming from John Rowan of Janney.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Well, since you're willing to speak about the lawsuit a little bit I figured I would just ask -- or just make sure that everyone understands and maybe just get your take on it. Obviously, you can read the complaint, we can see what the main tenets of it are.

When you settled with Massachusetts, I just want to make sure there was nothing in that settlement that had anything to do with usury laws, right? The settlement isn't totally clear, but it looked like it was two technical issues that one was a Massachusetts-specific requirement. And another one is about posting some resale value on a repossession. There was nothing that you settled in Massachusetts from the main charge of usury that you settled for, if I'm not mistaken.

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

Yes. The settlement agreement revolved around the two issues that you mentioned principally.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. So just moving past that. Obviously, there was a little bit of a jump up in G&A expense. Was that anything to do with legal expenses?

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

G&A expense increased due to increased expenses in the technology area and in legal.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. The provision expense, is it safe to assume that, excluding forecast changes, it's in the $90 million run rate based on the growth that you're putting on?

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

It was less than that in the fourth quarter. The new loan provision was $60 million, but again, keep in mind that unit volumes in the fourth quarter are typically at a seasonal low.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. And then just again, to go back to the competitive environment, obviously, fourth quarter. The funding markets for most subprime ABS were in disarray or at least the spreads were really, really wide, but we've seen a little bit of a retrenchment here in January. There are a lot of subprime ABS deals that have come out. Spreads are quite a bit lower than they were late last year. Is there anything that we can read through to the competitive environment? And how do you help us think of how this fits with you guys in a cycle that brings some spread back to you guys, if this would be any indication of more competition there's -- with more -- less risk-adverse funding markets?

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

Yes. Potentially, that causes the market to be a little bit more competitive. You're right, the market tone this year has been more constructive. You still have a situation where base rates are elevated, and credit spreads still not as high as they were in Q4, are certainly higher than they were for a number of years. So we'll have to see what happens, but it's conceivable that the competitive environment could become a little bit more intense if the funding markets continue to be constructive. We'll just have to see how it plays out.

Operator

(Operator Instructions) Next question will be coming from Rob Wildhack of Autonomous Research.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Just one more on the funding market. Given your origination growth and the better spreads now, why not tap the ABS market yourselves?

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

We certainly intend to, but at the end of the year, we had about $1.6 billion in unused availability at our committed revolving credit facilities. So a very strong liquidity position. But that's something we'll do at the appropriate time.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Okay. So safe to assume, and to tie it back to New York State, there's nothing in that lawsuit that would preclude you from continuing to tap the ABS market, right?

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

Correct. The complaint's a complaint, but there's nothing in there that would prohibit us from accessing the securitization market.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Got it. And then to switch over. In the press release, you called out forecasted profitability on a few different vintages. Can you define that for us? And then I'm kind of wondering why forecasted profitability for the '22 vintage would be significantly lower, but the forecasted collections are only 1 percentage point lower than initial.

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

Yes. Forecasted profitability, the way we're defining it there, is really forecasted economic profit, the non-GAAP financial measure we refer to in the press release. Relative to 2022, we're using a pretty low standard for significantly. It's basically 1.0% in the collection rate, which is it's arguable whether that's significant or not, but that's the standard we've chosen to use. '

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Okay. So 1.0% on collections is significantly lower in '22. Okay, I got it.

And then one more. On past calls, you've said that when you're growing originations, you probably buy back less stock. This quarter, you were able to do both. What's going on there? And how should we think about share repurchases if you do continue to grow in '23?

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

As we've said before, the first priority is always to make sure we have the capital that we need to fund anticipated levels of loan originations. So that's going to be the first priority. In terms of share repurchases, it just depends on how the capital markets function, what our growth rates are, and things like that. But the first priority will always be to fund new levels of loan originations.

Operator

(Operator Instructions) Our next question is coming from John Hecht of Jefferies.

John Hecht ***Jefferies LLC, Research Division - MD & Equity Analyst***

You touched on earlier with a set of questions about the last three quarters, write-downs in cash flows. I'm just wondering -- what do you -- like do you guys think about an attribution for that? Is it tied to structural factors on the loans recently? Is it tied to inflation? Is it because asset values are declining? Do you have a sense for the causation of that over the recent quarters?

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

It's tough to say precisely, but I think it's likely primarily the impact of inflation on a subprime consumer and then declining vehicle values for the last six, seven, eight months.

John Hecht ***Jefferies LLC, Research Division - MD & Equity Analyst***

And then, I don't know if you're willing to do this, but I mean, obviously, you guys are probably in communications with your dealer partners all the time on your comments about inventory levels and purchase volumes. Is it your perspective that the worst is behind the dealers, meaning that this system is starting to stabilize? Or do you guys think there's more to come in terms of reduction of demand and reduction in car prices? How do you think about,what's your kind of forward perspective?

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

Used car prices have declined, which has helped address affordability issues and the inventory situation is better than it was, but it's not where it was pre-pandemic, and used car prices are still elevated. Where it goes from here I think is anyone's guess. We don't have the ability to predict the future, so we'll just have to see.

John Hecht ***Jefferies LLC, Research Division - MD & Equity Analyst***

So with that in mind, maybe it seems like a more confusing picture. Would you consider yourself more selective? Or is there ways for you to tighten, given that uncertainty? Or is it just sort of just keep eyes wide open and it's a day-to-day thing?

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

I mean we always build a very significant margin of safety into the way we price our loans. We recognize that if you're writing a 60-month loan, there's a whole host of things you can't predict that will occur over the next 60 months. What will inflation do, what will unemployment do, what will used car prices do. So the way that we address all those uncertainties is by building a significant margin of safety into the way that we price. We're writing business that generally produces very high returns, and we price our business so that if loan performance is worse than expected, our loans are still highly likely to be profitable.

John Hecht ***Jefferies LLC, Research Division - MD & Equity Analyst***

I appreciate the color. Thank you guys very much.

Operator

(Operator Instructions) Next question will be coming from Ray Cheesman of Anfield Capital.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

Thank you. Just following up on John's question. As you look forward now, I'm guessing you have a model of what you expect the world to do. I'm wondering if you would be willing to share any of your modeling assumptions, like where do you think unemployment will be at the end of the year, or where do you think the 10-year will be at end of the year, the things that would drive that CECL model?

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

Like I just said in the last question, there's a whole bunch of things that are unforecastable, so we don't attempt to forecast the things that are unforecastable. We just address those uncertainties by pricing our loans of the big margin of safety. So when we put together our forecast of future cash flows, they're based on actual loan performance and the historical performance of loans with similar attributes. And those forecasts historically have been pretty accurate.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

As we proceed into 2023, and we read a lot of the press from the various talking heads about lower tax rebates and exhaustion of savings. Is your expectation that your pricing and risk adjustments are underway to protect you? So you're adjusting your terms on the fly and you're maintaining margins and maintaining profitability and -- it's just that over the course of the last couple of quarters, the water seems to... the tide is going out on the economy. And I just want to make sure that I'm confident you guys are as greedy as historically. I'm sorry to say it that way, but you're a highly profitable company, and I just want to make sure that CACC stays that way.

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

Yes. --When we're making decisions about how to price our loans, we are certainly considering what we are experiencing from a loan performance perspective.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

And then just one more. The fact that the used car market is dropping, I guess I saw recently, Ally expects 13% and other people expect between 10% and 20%. That's not great news for prior vintages, but it actually should be good for growth of future vintages, right?

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

I would agree with that.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

Okay. Then thank you very much. You've given me some confidence, Doug. Thank you.

Operator

(Operator Instructions) Our next question will be coming from Shanna Qiu of Bank of America.

Shanna Qiu ***Bank of America***

Doug, this is Shanna from Bank of America. I think your bonds now are trading in the low 90s, and you talked about capital allocation with a focus on investing and maintaining enough to originate your growth in volumes next year or this year. But with the bonds in the low 90s, could you look to maybe be opportunistically addressing some of the maturities before they come due in 2024?

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

Conceivably; we've explored retiring some of the bonds early. Obviously, we haven't elected to do anything thus far, but we've taken a look at that, and we'll just have to weigh the attractiveness of that alternative with the need to invest in new loans.

Shanna Qiu ***Bank of America***

And then I guess, previously, you had filed the 8-K expecting the New York lawsuit. Have you seen anything from any of the other states potentially suggesting that they are moving forward with lawsuits, or you haven't really seen anything new come across yet?

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

We're not going to say anything about the existing lawsuit other than what Ken mentioned earlier in the call.

Operator

(Operator Instructions) Our next question is coming from Christopher Ryan of Radcliffe Capital.

Christopher Ryan ***Radcliffe Capital - Senior Analyst***

Is there any timeline known right now about the New York CFPB lawsuit they can give us?

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

I can't answer that one, no.

Christopher Ryan ***Radcliffe Capital - Senior Analyst***

Okay. And then what was the average price paid for share repurchases in the quarter?

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

It was 208,000 shares at an average price of, I believe, $455 -- so that's around $100 million.

Christopher Ryan ***Radcliffe Capital - Senior Analyst***

Got it.

Operator

Thank you. That concludes today's Q&A session. I would like to turn the call back over to Mr. Busk for any further additional comments or closing remarks.

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

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 concludes today's conference. We thank you for your participation. Everyone may disconnect.