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Q2 2021 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS

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Kenneth S. Booth *Credit Acceptance Corporation*
Jay Martin *Credit Acceptance Corporation*

CONFERENCE CALL PARTICIPANTS

Moshe Ari Orenbuch *Crédit Suisse AG*
Raymond Cheesman *Anfield Group, LLC*
Robert Henry Wildhack *Autonomous Research LLP*

PRESENTATION

Operator

Good afternoon, everyone, and welcome to the Credit Acceptance Corporation Second Quarter 2021 Earnings Call. Today's call is being recorded. A webcast and transcript of today's earnings call will be made available on Credit Acceptance website.

At this time, I'll now turn the call over to Credit Acceptance's Chief Treasury Officer, Doug Busk.

Douglas W. Busk ***Credit Acceptance Corporation***

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Second 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 28.7% and 20.5%, respectively, compared to the second quarter of 2020.
- An increase in forecasted collection rates for loans originated in 2017 through 2021. This resulted in a $104.5 million increase in the forecasted net cash flows from our loan portfolio.
- Adjusted net income, excluding a onetime reversal of stock compensation expense increased 44% from the second quarter of 2020 to $221.4 million.
- Adjusted earnings per share, excluding a onetime reversal of stock compensation expense, increased 53% from the second quarter of 2020 to $13.18.
- Stock repurchases of approximately 598,000 shares, 3.6% 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 of Finance and Accounting and I, will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question is from the line of Moshe Orenbuch from Credit Suisse.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division***

Doug, if possible, could you talk a little bit about the $104 million that you said in terms of expected higher collections? And just talk us through how that flows through both on a GAAP and an adjusted basis?

Douglas W. Busk ***Credit Acceptance Corporation***

Yes. The $104 million was driven by an improvement in the forecasted collection rates on loans originated in recent years. For adjusted accounting purposes, that improvement will be reflected in the yield on the portfolio that will be taken into our financial results on a level-yield basis over time. For GAAP, the improvement in forecasted cash flows goes through the provision as a reversal of the provision and adjusts the allowance to the point where the net carrying value of the loan asset would equal the present value of the forecasted net cash flows.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division***

Got it. And I mean, I just saw -- it's not on your website yet, but I did see on the SEC's website that you filed a 10-Q. So I'm just opening it as we speak. So is there any update from the standpoint of the litigation with Massachusetts or the CFPB that we should be aware of?

Douglas W. Busk ***Credit Acceptance Corporation***

Not really. We have a little bit of an updated disclosure in the 10-Q relative to Massachusetts, particularly. We're continuing to work toward finalizing an agreement with the Commonwealth that is consistent with the tentative agreement we came to back in April.

Moshe Ari Orenbuch ***Crédit Suisse AG***

In that time frame, I guess, it's been just over three months, that's kind of on the longer end for one of these. I mean is there anything that we should -- the only thing we know about it is that you agreed to pay them $27 million. Is there anything else that we should be aware of?

Douglas W. Busk ***Credit Acceptance Corporation***

We can't really say anything other than what we've already disclosed. We're continuing to work with the Commonwealth, as I said, toward an agreement that's consistent with the understanding we reached in April. Beyond that, we can't really say anything.

Moshe Ari Orenbuch ***Crédit Suisse AG***

Since there's a subsequent CID from the CFPB in June which has been kind of ongoing for a period of time. Anything different in what they're asking for that we should know about?

Douglas W. Busk ***Credit Acceptance Corporation***

I can't really comment beyond what's in the 10-Q.

Operator

Next question is from the line of Ray Cheesman of Anfield Capital.

Raymond Cheesman ***Anfield Group, LLC***

Doug, I wanted to ask you guys, with COVID cranking back up again and being very topical and, of course, later this week unless something changes, the eviction and foreclosure moratorium is kind of running out. Is it your expectation that just like the last two times kind of early in the pandemic and then over that extended Christmas quiet period, do you think there's a risk of another quiet period if the customer base is impacted by either a fear of the disease or fear of making rent payments?

Douglas W. Busk ***Credit Acceptance Corporation***

When you're referring to a quiet period, what specifically are you referring to?

Raymond Cheesman ***Anfield Group, LLC***

I'm thinking the decline in business that occurred over the winter.

Douglas W. Busk ***Credit Acceptance Corporation***

Certainly possible. I don't think many things in this pandemic have played out as anyone would have thought, so I think there's uncertainty into how things will progress from here. So anything is possible.

Raymond Cheesman ***Anfield Group, LLC***

Second question would be, I think that I've been watching the Manheim get a little soft or possibly even roll over here. Does that mean your optimism for the future might go up if it doesn't cost an arm and a leg to get a used car in the future and maybe more people can afford one?

Douglas W. Busk ***Credit Acceptance Corporation***

Yes, I think that would be helpful. As we pointed out in our earnings release, I think used car prices being at elevated levels have presented challenges for our customer base. So that would likely be helpful.

Raymond Cheesman ***Anfield Group, LLC***

Okay. And then just a last one. You and a lot of other financial institutions were beneficiaries of CECL reserve releases during this particular reporting period. And I'm wondering, is there a chance that there's more reserve releases this year to come? Or do you guys feel like you've got your arms around the best information right here and now?

Douglas W. Busk ***Credit Acceptance Corporation***

We adjust our forecasted collection rates every month. And that adjustment is based primarily on how the loans actually perform versus our expectations. So if loan performance continues to exceed, which is far from certain, then there will be additional provision reversals. And if loan performance declines, then the opposite will occur. That would be incremental provision. So it's just all a function of how the loans perform.

Operator

(Operator Instructions) Next question is from the line of Rob Wildhack of Autonomous Research.

Robert Henry Wildhack ***Autonomous Research LLP***

In the press release, you attributed the slowdown in this quarter's unit volumes to reduced inventories and higher used car prices. Inventories have been depressed and used car prices have been elevated for some time now, though. So I'm wondering if there's anything else that might have contributed to the deceleration in this particular quarter?

Douglas W. Busk ***Credit Acceptance Corporation***

Nothing in particular. I think that from our understanding, both the used car prices, especially for our segment of the market, and inventory levels got incrementally worse during the quarter. So I think that was, as we say, the most significant contributing factor. The other thing is, as I look at the industry data, which we only have through May, it seems like we lost a bit of share in the quarter. So that would be a contributing factor as well.

Robert Henry Wildhack ***Autonomous Research LLP***

Okay. Do you have a hypothesis for why you might have lost share in the quarter?

Douglas W. Busk ***Credit Acceptance Corporation***

The most likely explanations would be that the inventory challenges have been more significant with independent dealers. As you know, we get the majority of our originations from independents.

And then I think that there's probably some reluctance on behalf of dealers, given the scarcity of inventory, to finance a loan with Credit Acceptance given that the upfront gross is less than it would be with one of their traditional lenders. So we've gotten feedback that some dealers, given the scarcity of inventory, are electing not to finance that consumer and waiting for a higher credit quality borrower to come on the lot.

Robert Henry Wildhack ***Autonomous Research LLP***

Okay. And I appreciate that you can't comment on the lawsuit in Massachusetts or the settlement there, but wondering if you could comment on your business in Massachusetts. Has there been any noticeable change in volumes or dealer relationships since you announced the preliminary settlement?

Douglas W. Busk ***Credit Acceptance Corporation***

Nothing significant.

Operator

Next question is again from the line of Ray Cheesman of Anfield Capital.

Raymond Cheesman ***Anfield Group, LLC***

I just had a quick follow-up. There is an awful lot of capital out there that is chasing loans. And often, people are being a little bit crazy to get volume. And you mentioned market share a minute ago. I'm wondering if you're seeing any disruptive players disturbing the market where you service your customers?

Douglas W. Busk ***Credit Acceptance Corporation***

Well, you're certainly right that the more capital that the industry has access to, the more competitive it tends to be. I don't really have any particular insight into the business practices of others in the industry, so I can't provide a good answer to your question, Ray.

Raymond Cheesman ***Anfield Group, LLC***

But your market share, it's not because you feel like somebody is trying to dramatically undercut the kind of rational rate that should be charged for the risk that's assumed?

Kenneth S. Booth ***Credit Acceptance Corporation***

It's really hard to say. I mean there's lots of participants in the market; we price our business to try to maximize the economic profit, we try to make an acceptable return on what we forecast collections for. So we've looked at it from our perspective. We're disappointed that volume is down, but we view this kind of as a temporary situation. How long it lasts, we don't really know. But we think the market will stabilize at some point. We feel good about the business that we're writing.

Operator

(Operator Instructions) With no further questions in the queue, I'll now turn the conference back over to Mr. Busk for any additional or closing remarks.

Douglas W. Busk ***Credit Acceptance Corporation***

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. You may now disconnect.