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Q3 2023 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS

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

CONFERENCE CALL PARTICIPANTS

John Hecht *Jefferies LLC, Research Division - MD & Equity Analyst*
John J. Rowan *Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance*
Robert Henry Wildhack *Autonomous Research US LP - US Capital Markets Specialty Financials Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation Third Quarter 2023 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 Third Quarter 2023 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:

A decrease in forecasted collection rates that decreased forecasted net cash flows by $69 million, or 0.7%, compared to a decrease in forecasted collection rates during the third quarter of 2022 that decreased forecasted net cash flows by $85 million (corrected by the company after the call), or 0.9%.

Forecasted profitability for Consumer Loans assigned in 2020 through 2022 that was lower than our estimates at September 30, 2022, due to a decline in forecasted collection rates since the third quarter of 2022 and slower forecasted net cash flow timing during 2023, primarily as a result of a decrease in Consumer Loan prepayments to below-average levels.

Unit and dollar volumes grew 13.0% and 10.5%, respectively, as compared to the third quarter of 2022. The average balance of our loan portfolio on a GAAP and adjusted basis increased 5.9% and 10.6%, respectively, as compared to the third quarter of 2022.

An increase in the initial spread on Consumer Loan assignments to 21.4% compared to 20.2% on Consumer Loans assigned in the third quarter of 2022.

An increase in our average cost of debt, which was primarily a result of higher interest rates on recently completed or extended secured financing and the repayment of older secured financings with lower interest rates.

Adjusted net income decreased 22% from the third quarter of 2022 to $140 million. Adjusted earnings per share decreased 20% from the third quarter of 2022 to $10.70.

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 John Rowan of Janney Montgomery Scott.

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

When I think back over a long time frame, in looking at the company and every cycle that we've seen, whether it was the great financial crisis or COVID, it was roughly about three quarters of the charges that you took to right size the forecasted collections. And then obviously, after that, those forecast revisions went away.

We're at six quarters now in a row of forecasted collection revisions on the downside. Is there something different about this environment that makes it more difficult to get that number right? Is it still COVID reverberations, CECL, or car prices? I'm just trying to figure out why we're so much longer into the cycle and we're still seeing these negative charges.

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

It doesn't have anything to do with CECL. I mean that's just accounting. In terms of estimating forecasted collection rates, I don't have a perfect reason as to why it's taken longer for the '22 vintage, in particular, to settle in.

Those loans were originated in a pretty unique time. It was very competitive in the industry at very elevated used car prices, and we have had the impact of inflation, which is something that we've never previously had to deal with. That's really about the best answer I can give you.

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

Okay. I saw the 10-Q (corrected by the company after the call) came out. It doesn't seem like there's any material disclosures regarding the CFPB and New York AG suit, but it does say that there's an update that has to be given on November 3.

Is there anything you can tell us about what that update would include, or is that a possible time frame in which this case would move forward again because, obviously, it's still currently stayed? I just want to understand what happens on November 3.

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

Yes. I don't think that anything is really going to happen with the case until the Supreme Court rules on the constitutionality of the CFPB. The court has granted a motion to stay on our case pending that decision. I don't know exactly what will be discussed in early November with the court, but the court has granted a motion to stay pending the Supreme Court's decision.

Operator

And our next question comes from John Hecht of Jefferies.

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

My question is related to John's prior question, because this is a longer cycle. In prior cycles, you have emerged as a price maker as other competitors have fallen back.

If you look at the spreads that you're issuing now, they're still below where they were even a few years ago. I'm wondering how you would describe the competitive market? Is there something that you'd see in the future or any indications that it may be becoming more favorable because we've gone through such a tough cycle for a period of time?

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

We think the competitive environment is relatively favorable today. We grew the loan portfolio and grew originations in Q3 at rates that we're happy with. Volume through the first 28 days of October is up materially, so I think the competitive environment is favorable.

The October volume would indicate that it's even more favorable recently. It's certainly not a situation like that, that existed in the credit crisis when the industry really didn't have access to capital for a period of time, but I think that the competitive environment is certainly better than it was a year ago. I don't know how that's going to play out in the future, but we're pleased with how it's going to date.

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

Obviously, you're writing down the expected cash flows and you had kind of fits and starts over the past few quarters in that. Maybe can you just discuss the credit environment?

Is it a consumer that's just been exhausted by inflation, or is it more tied to asset values in the market? How do you describe the credit and the consumers' ability to service their debts right now?

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

Yes. I think it's a combination of several factors, probably the two that you mentioned, asset values and inflation, would be the two most material contributors.

Operator

(Operator Instructions) And our next question comes from Robert Wildhack of Autonomous Research.

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

Just to follow up on the last point there. Why do you think the competitive -- or what's the reason behind the improvement in the competitive landscape? Is that structural? In other words, competitors going out of business, or is that temporary, i.e., some just pulling back for a bit?

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

There have been some companies that have gone out of business or exited the market, but they haven't been huge participants in used vehicle financing to subprime consumers. I think it's just more a function of other industry participants having to price their loans differently due to the increase in interest rates. I think people are also probably reacting to softness in credit performance.

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

Okay. And then as it relates to the downward revisions in forecasted collections, have you adjusted your approval rate at all in the recent quarters? And then, did you change your approval rate at all in October?

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

We haven't seen a material -- I mean, we approve everyone, so we haven't seen a change in our approval policies, and we haven't made any meaningful changes in policy or pricing in October.

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

Okay. No change in October.

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

No material changes, no.

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.