CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
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5:00 p.m. ET

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation First Quarter 2020 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 Senior Vice President and Treasurer, Doug Busk.

Douglas Busk – *Credit Acceptance Corporation*

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation First Quarter 2020 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 the 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.

At this time, Brett Roberts, our Chief Executive Officer; Ken Booth, our Chief Financial Officer, and I will take your questions.

Operator

(Operator Instructions) Our first question comes from Moshe Orenbuch with Crédit Suisse.

Moshe Orenbuch – *Crédit Suisse*

Great. Can you hear me okay?

Douglas Busk – *Credit Acceptance Corporation*

We can.

Moshe Orenbuch – *Crédit Suisse*

Okay. I guess for starters, there's a bunch of new disclosures here, and I'm looking on Page 23 of the 10-Q. You've got your delinquency numbers; how should we be taking those into account as we think about your provisioning practices in subsequent quarters?

Douglas Busk – *Credit Acceptance Corporation*

I think the best thing to do in terms of understanding our provisioning is to look at our forecast of future cash flows and our forecasted collection rate. We think that information is the most useful relative to assessing credit quality and relative to understanding changes in future cash flows.

Moshe Orenbuch – *Crédit Suisse*

Right. Although it's not really helpful in forecasting that loan loss provision, right? It's certainly not the only factor that's involved in that.

Brett Roberts – *Credit Acceptance Corporation*

I think if we have any shareholders that are still focused on the provision, they need to go back and do some homework. The adjusted results are really what we look at to run the business, and that's what shareholders should be looking at when they're trying to make an investment decision and there's no provision in the adjusted results.

Moshe Orenbuch – *Crédit Suisse*

Got you. Okay. And in terms of your forecasted cash flows, you talked about kind of reducing your expectations by about 2% or in the neighborhood of $200 million. Can you talk about what you've assumed there? In other words, what's going on with respect to your borrowers who are currently receiving stimulus? What you've assumed about what happens when that is no longer in place? Like how should we think about that part of the process?

Brett Roberts – *Credit Acceptance Corporation*

Right. So as we described in the release there are really two components to the net cash flow change in the quarter. One is about $44 million, which is just the mechanical forecasting model responding to what happened so far in Q1. And then the remainder, about $162 million is a subjective adjustment made on top of that to consider the ongoing impact of the COVID pandemic. If you look at the release, we provided some numbers on front end collections and total collections, the year-over-year change. That's probably really the best place to look in the release for what has actually happened so far. There's two tables there. One is just the way the calendar falls, and the other one we adjust for the calendar to make it more comparable. Now if you look at the second table, what you'd see is we saw a pretty sharp falloff in front-end collections in March, the last two weeks of March, came back a little bit in April, particularly in the last half of April, and May so far has been pretty good.

Moshe Orenbuch – *Crédit Suisse*

How do we adjust that for the size of the portfolio? I assume that we should think about that as a percentage of loans, right? Not as an absolute amount.

Brett Roberts – *Credit Acceptance Corporation*

In terms of the forecast change?

Moshe Orenbuch – *Crédit Suisse*

Well no, no, that's just a rate of change in the dollars collected, right? Year-over-year, that's not relative to your expectations. That's just what was it in 2019 and what is it in 2020, right?

Brett Roberts – *Credit Acceptance Corporation*

Yes. Just a simple way to look at it. A reasonable assumption would be that if you didn't see a change in the collections then probably no forecast adjustment would be necessary. Since we did see a change in collections in March and April, the March change in collections caused that first part of the forecast that I talked about, the $44 million. And then because we're in the early stages of a pandemic, we expect there'll be an ongoing impact, so we made a subjective adjustment on top of that.

Moshe Orenbuch – *Crédit Suisse*

Right. I guess then I'll ask the question I asked before about those May numbers. I mean you basically collected 8.5% more on the front end and 4.9% more in total, but that is helped, as you correctly point out in here, but that's helped by the current situation. Does your write down of 2%, does that assume that that doesn't deteriorate at all? I guess that's what I'm asking.

Brett Roberts – *Credit Acceptance Corporation*

No. The $44 million is based on what happened so far, the $162 million assumes that there'll be some continuing impact in the future.

Moshe Orenbuch – *Crédit Suisse*

And can you talk about how much, like how you came about that forecast?

Brett Roberts – *Credit Acceptance Corporation*

I don't really want to get into the components. I mean, I think you're looking at a highly complex situation. I think we say in the release that given the number of variables it's hard to have a great degree of confidence in any number that you would put forth. We took our best shot at it. The $162 million is our best estimate. We do say it's subjective. We'll just have to see how this pandemic transpires, how the economy transpires, how vehicle values respond. There's obviously a lot of variables to try to get your arms around.

Moshe Orenbuch – *Crédit Suisse*

Got you. All right. I was hoping to get some understanding of what they were. And the last question for me is, the customers that you're underwriting today, are they people with employment? Or are they people who are receiving stimulus checks and unemployment checks—not stimulus checks, but unemployment checks? So would you underwrite a borrower who is being paid by the government essentially?

Brett Roberts – *Credit Acceptance Corporation*

The vast majority of the borrowers are employed at the time the loan is made.

Operator

And our next question comes from John Rowan with Janney.

John Rowan – *Janney*

So I just want to understand whether the reduction in repossessions is that a function of forbearance? Or is that a function of social distancing and various state restrictions?

Brett Roberts – *Credit Acceptance Corporation*

There's a few states that have restrictions, and we're obviously following all those restrictions, but that was a decision that we made to stop repossessions early on in the crisis.

John Rowan – *Janney*

Okay. So the vast majority of that would be, actually, you guys giving out forbearance to the consumers?

Brett Roberts – *Credit Acceptance Corporation*

Well, we made a decision not to repossess.

John Rowan – *Janney*

Okay. Do you still have a 6-month net income covenant -- positive net income covenant? I believe it might have been on the revolver at some point?

Douglas Busk – *Credit Acceptance Corporation*

Yes, we still have that covenant.

John Rowan – *Janney*

Okay. So that would mean that next quarter you would need to post earnings larger than or equal to the net loss this quarter not to break that covenant, correct?

Douglas Busk – *Credit Acceptance Corporation*

Yes. You need to make some adjustments to the first quarter loss for items that aren't counted there. But yes, the idea is right. You'd have to have net income adjusted for certain items in Q2 that was greater than the net loss in Q1, adjusted for certain items.

John Rowan – *Janney*

Okay. Just looking at the 10-Q, I just want to make sure I'm counting it correctly. It seems like there are three new issues as far as legal disclosures. A New York subpoena, it seems like you've gone back and forth with a new CID from the CFPB, and then also something in Maryland. Am I reading that correctly? Or are those older issues that you're just updating?

Douglas Busk – *Credit Acceptance Corporation*

Certainly, Maryland and the CFPB are newer issues. New York, I think, existed prior to this quarter.

John Rowan – *Janney*

Okay. And then just lastly, we've heard from some lenders that when they set their loss expectations and their provision and allowance, they were using the March 31 economic forecasts. A lot of people have said, we're using Moody's forecast of 9% unemployment. I just want to see, I mean, whether you guys had a hard cut off at March 31? Or are you treating the post quarter end issue, the subsequent event, and also including that in your loss estimate, in your provision expense here for the quarter?

Douglas Busk – *Credit Acceptance Corporation*

We're basically including everything we know up until we released and filed the Q.

Operator

And our next question comes from Vincent Caintic with Stephens.

Vincent Caintic – *Stephens*

So first one, and I think something that I've gotten questions from a lot of investors is just when I think about your funding and some of the covenants to the funding. Just wondering if you could talk about if there's any issues there because there's been some discussion about that maybe with forecasted collections coming down that could drive some triggers to your securitizations. Any thoughts there? Any concerns there?

Douglas Busk – *Credit Acceptance Corporation*

We have two sets of covenants in our securitization. One relates to early amortization events. So our securitizations revolve for 24 months, after which they amortize. There are early amortization events that would cause that revolving period to cease and the amortization period to commence early. So that's one set of considerations. And then the other is termination events, when basically the whole deal would be in default. The early amortization events are set at a higher level than the termination events. So in other words, more degradation would have to occur for a termination event to occur as opposed to an early amortization event. The most relevant early amortization event currently is one which would cause the revolving period to cease if cumulative actual collections are less than 90% of cumulative forecasted collections, and that's based on a cash flow stream delivered at closing, if it were less than 90% for three consecutive months. At this point, we've accumulated a nice cumulative cushion on all of our securitizations. So we don't anticipate any near-term difficulties avoiding an early amortization event. That obviously could change in the future depending on the severity and duration of the pandemic crisis.

Vincent Caintic – *Stephens*

Okay. That's very helpful. And is that 10% comparable to the—so your forecasting collection rate was only down 2.3%, which I think is pretty impressive. Is that the best comp against the 10% that you mentioned on the early amortization event?

Douglas Busk – *Credit Acceptance Corporation*

You got to consider both the amount and timing, it directionally goes the same way, but it's not exact.

Vincent Caintic – *Stephens*

Okay. That's very helpful. Next question on the competitive environment. So understanding that your volumes are down—unit volumes seem to be down more than dollar volumes. I'm just wondering if you're seeing in this environment if some of the loans you're placing in April and May are higher quality than you would have gotten in the past, because if I remember correctly, back in 2011, your spreads were good and the loan quality was good coming off with the last recession. So just trying to understand what maybe you're seeing now that maybe the bottom of this has been reached.

Brett Roberts – *Credit Acceptance Corporation*

I think in terms of volume, what you saw in the first quarter is we were flat through February. March was down 20-plus percent as the pandemic started to impact our dealerships. April was down about the same. Although the last part of April was a lot stronger than the first part. And then so far in May, we're up 20-plus percent. In terms of the quality, I think it's too early to say. What happened at the end of the financial crisis, kind of 2008, 2009, was the loans performed better than you would have expected had you just looked at what we knew at loan origination. Couple of reasons for that. One would be kind of reverse adverse selection. In a highly competitive environment, we know the loans don't perform as well. That's because there's a lot of lenders competing for those loans and so we get adversely selected. As competition thins out, you see the opposite impact. I think that's one reason why the '08 and '09 vintages performed so well. The second reason is that when competition thins out, it's very hard for borrowers in our market to get a loan. And they know that. They value the loan. We give them more than they would get in a more competitive period, and so they're more likely to pay for it. And they probably realize that getting another loan if they don't pay for this one would be difficult. So whether we'll see those two things play out this time or not, it's just too early to say.

Vincent Caintic – *Stephens*

Okay. Very helpful. And then last question for me. So there are some concerns about the auctions being closed. Does that have much of an impact to your forecasted collections going forward?

Brett Roberts – *Credit Acceptance Corporation*

I'm sorry, what? I didn't catch the question. Doug did you hear him?

Douglas Busk – *Credit Acceptance Corporation*

It's about the auctions.

Vincent Caintic – *Stephens*

Yes, the auctions being closed. Does that have a material impact on your collections, your overall collections?

Brett Roberts – *Credit Acceptance Corporation*

Well, right now, we're not repossessing cars. We had an inventory that was at the auction when the crisis started, but a lot of the auctions are actually open. They're doing virtual sales. So we are able to liquidate some of the inventory that we had at the start of the crisis. We aren't adding to it now. So it really isn't an issue. But you'll see a timing difference. You can see that in the tables that we put in the release. Because we're not repossessing cars, and we're not seeing those auction proceeds at their usual level, total collections have fallen more than front-end collections, but we provided all those numbers. When we start repossessing vehicles, again, you'll see some of that flip around. I mean the other issue you have there is the values that you're getting at auction aren't what they were before the crisis. So one of the big variables that will determine what the actual collections are is, how long will it take for those values to rebound and to what extent will that occur.

Operator

Our next question comes from Randy Heck with Goodnow Investment.

Randall Heck – *Goodnow Investments*

Brett and the team. First of all, I want to say this—the quarter was pretty damn good relative to what I would have expected or probably anyone would have expected in terms of both collections, most importantly collections, but also originations. So first question is the May—the new chart you have in there for the percentage, what does that reflect, not to mention the back end of May, the back end collections were up 7.3%. Does that mean that you're now repossessing cars? Or is it something else?

Brett Roberts – *Credit Acceptance Corporation*

I didn't hear all of that, Randy, but I think I heard enough of it to give you an answer.

Randall Heck – *Goodnow Investments*

Yes. I mean why are the collections better in May than they were in January and February?

Brett Roberts – *Credit Acceptance Corporation*

I think a couple of things. People got behind in March and April. And then I think you have to assume that the stimulus money that people received, possibly in addition to the enhanced unemployment benefits, gave people enough cash flow to be able to make their payments. Having said that, I think if you'd ask me in the third week of March whether I think May collections would be growing faster than they were in January and February, I would have said no, that could never happen. So I do think you're right that so far what's transpired is far from a worst-case scenario.

Randall Heck – *Goodnow Investments*

Okay. And then the volumes, I thought January, February flattish against, well, that reflected the old competitive environment, then May being up 22%, Does that reflect any changes in your pricing whether it's you've loosened pricing? Or did you do the opposite?

Brett Roberts – *Credit Acceptance Corporation*

I prefer not to get into pricing discussions, but we said in the release that there are two reasons why we believe that May volumes are better than the prior months, one was that you started to see dealers open back up again. Now that's not going to lead, obviously, to a year-over-year increase because they were open last year. I do think the stimulus money that's out there had an effect on our market. And it's certainly possible—we don't know this at this point—that the competitive environment has improved.

Randall Heck – *Goodnow Investments*

Okay. The last thing I had was the estimated negative cash flow impact from the quarter. Normally, when you have negative variance in pools, you estimate the negative cash flow effect for the balance of the -- your best estimate at that point in time for the life of the loan, the remaining life of the loan. And so that's the $44 million that you noted. The $130 million, just so I understand that. That's over and above what you would normally be suggesting is going to be the hit over the life of the loan for the entire portfolio for the balance of the life of the portfolio, is that correct?

Brett Roberts – *Credit Acceptance Corporation*

Yes. But I'd say a little bit differently. So the $44.3 million, that's the model responding to what occurred in March. So we had obviously lower collections in March. Second half of March, in particular, people weren't making their payments. So the model looks at that and says, okay, the customer missed their payment. So I'm going to look at all the historical data that looks like that customer that missed their payment, and it's going to reduce the estimated cash flows for the life of that loan. So it's just a model responding to what happened already in March. But the model doesn't necessarily know about COVID-19. It doesn't look out and say, well, not only did that customer miss that payment in March, but they're going to have continued difficulty in the future because of the uncertain economic environment. So that's where we have to go in, and we have to make an adjustment on top of the model because we know the model doesn't consider the ongoing effect of the pandemic. So that's what the $162 million is.

Randall Heck – *Goodnow Investments*

Okay.

Brett Roberts – *Credit Acceptance Corporation*

If you look back in 2008, we made a similar series of adjustments. I think, one in the second quarter of '08 and one in the fourth quarter of '08, of about the same magnitude. If you add the two numbers together in the low 2%. Those adjustments we made in 2008 turned out to be appropriate. If you look back on it, they were pretty accurate. Not to say the one we made this quarter will be accurate. I think it's too early to tell, but we certainly don't think it's zero on top of the $44 million. We don't think the model incorporated everything bad that's going to happen in the future. But there's just too many uncertainties to have a lot of confidence that the $162 million is the exact right number.

Randall Heck – *Goodnow Investments*

Okay. So essentially, in terms of the number, plus $44 million, we're talking $15 a share, more or less -- if it's the cost of the crisis, it's not an ongoing cost, but it's the cost of the crisis. And going forward, other things being equal, if history is any, if we can rely on the history, the competitive environment is going to be substantially better here on out for some period. And then just the last point I wanted to make was Brett, once again, you wrote a beautiful letter to shareholders, read it and a lot of your questions that are being asked on the call will be answered.

Brett Roberts – *Credit Acceptance Corporation*

Thanks, Randy.

Operator

Our next question comes from John Hecht with Jefferies.

John Hecht – *Jefferies*

So I just want to make sure I understand the difference now between the GAAP and then adjusted earnings. I mean we've always been accustomed to the floating yield adjustment. But effectively what you're doing now, just to make sure I've got my kind of ducks in order, do I add back the entire provision, put that to the extent you're going to make adjustments in your cash flow collections that would affect yield on a going-forward basis? In effect, take yields down a little bit more going forward because of the loss of your expected cash flows? Is that the right kind of formula to deploy to this?

Brett Roberts – *Credit Acceptance Corporation*

Yes, that's the way that we look at it. As we run the business, we use the adjusted results. If we have a negative cash flow change that reduces the yield. I think we disclosed that in the second page of the release and the adjusted results section. That's how we look at it. I think if you're trying to use the GAAP results to understand the economics of the business, I think it's very, very challenging to try to do that.

John Hecht – *Jefferies*

Okay. That's helpful. And then did you guys disclose or do you have plans of when you're going to get back in the market for repossessions? And second is, how much of your overall cash flows are reliant upon repossession-like activity?

Brett Roberts – *Credit Acceptance Corporation*

We haven't made any announcement in terms of how we plan to pursue repossessions in the future. In terms of percentage of our total cash flows, somewhere around 6%, 7% is repossession proceeds.

John Hecht – *Jefferies*

Okay. And then I'm wondering, it's pretty impressive that you guys likely went from a largely intact call center focused collections to, I imagine, a large degree of work-at-home collections. Were collections, was productivity impacted at all? Maybe if you could just give us some commentary about the adjustment to distant collections versus all in one center and how you guys adjusted so rapidly?

Brett Roberts – *Credit Acceptance Corporation*

Yes. I would say, overall, extremely pleased with that transition. The team was able to react to it very early. It went very smoothly. Not just in the collections area, but really in every area of the business. We've got a great culture. We got great people. They're adjusting to a different work environment, really in an extraordinary way. I couldn't be happier with how all that went.

Operator

Our next question comes from Arjun Tuteja with Jarislowsky, Fraser.

Arjun Tuteja – *Jarislowsky Fraser*

Brett, first of all, congratulations on getting featured on Larry's book, Dear Shareholder, he talks about all the CEOs, which write good shareholder letters and you made it there. So I think it's a well-deserved congrats on that.

Brett Roberts – *Credit Acceptance Corporation*

Thank you.

Arjun Tuteja – *Jarislowsky Fraser*

And so my question is about your latest shareholder letter, which came out earlier this month. When I compare it to your 2007 letter, which came out in March 2008, it seems you are a bit more cautious this time around. You talk about decreasing economic profit, and you didn't talk a lot about competitors pulling back. Though the last recession pointed out two different things, and I think you were optimistic in your 2008 letter. So can you help me in understanding the difference, the way you are seeing it?

Brett Roberts – *Credit Acceptance Corporation*

Yes, I don't know. I'd have to go back and read the prior letter. I don't know if I'm more or less optimistic. But we're in the early innings of what is a very significant challenge. So far, I think you can be -- there's certainly room for optimism when you look through the results from the first quarter. But you have to remember, it's very, very early. This is something that is without precedent. We don't know how it's going to unfold. And I think if it came through in my letter that I'm cautious that is an accurate reflection of how I feel.

Arjun Tuteja – *Jarislowsky Fraser*

Okay. Okay. But do you see, say, unemployment going up one thing. Unemployment went up in 2008 as well. Would this jump make you more cautious than last time just because the number is higher as it is right now?

Brett Roberts – *Credit Acceptance Corporation*

Yes, I think so. I think with that, that crisis played out over a longer period of time. You had more time to react to what you were seeing. This crisis is much different, not only is the magnitude much greater, but the time period has been greatly compressed. So again,
I don't think there's a historical period you can look at and say, yes, it's going to play out exactly like that historical period. The financial crisis is as close as you get, but I don't think it's comparable enough to make me feel like caution isn't warranted.

Operator

Our next question comes from Sanjay Sen with Bloomberg.

Sanjay Sen – *BloombergSen*

Guys just a couple of questions here. Brett, I know you said you didn't want to talk about pricing for you in specific. But if you could say anything at all about what you're seeing in the marketplace regarding pricing? That would be interesting. And then I have a bit of a housekeeping question for Doug there on the question on covenants and the revolver and net income. And I just want to know, I think a couple of quarters ago, you mentioned how lenders were using your adjusted net income numbers. And I think Doug alluded to that there. So won't we see the positive adjusted net income this quarter, is that really what they're going to use and therefore, you are well on side of any covenant issues with the revolvers?

Brett Roberts – *Credit Acceptance Corporation*

I mean I don't really have any insight into how others are approaching their business from a pricing perspective. It's just—it's too early. There's a lot going on. Customers have money because of the stimulus. We had a period where the dealerships were closed, so you might have some pent-up demand. You have dealers that were gradually opening during the latter part of April and May. And then you have the competitive environment and breaking out all those factors at this point, I just don't have enough information to be able to give you much color on that.

Sanjay Sen – *BloombergSen*

Sure. Okay.

Douglas Busk – *Credit Acceptance Corporation*

Relative to the adjusted numbers, the adjusted numbers are used to determine the value of the loan asset for our borrowing basis on our revolving credit facilities. They are not the basis for the covenant that John Rowan inquired about earlier, the $1 of minimum net income for two consecutive quarters. So that's not the way that that covenant is calculated.

Operator

Our next question comes from Rob Wildhack with Autonomous Research.

Robert Wildhack – *Autonomous Research*

Question on borrower health and unemployment specifically. When we've gone through previous downturns, you've got borrowers who could find work, just maybe not the ideal level or at lower levels. But this time, you have a different situation; not only is unemployment significantly higher, but you're going to have people who are reluctant to return to work for safety reasons, you're going to have industries totally changing the way they operate. How do you think about those things in this new environment and factor that in when you're forecasting collections?

Brett Roberts – *Credit Acceptance Corporation*

Yes, I think your description of what's going to happen in the future is certainly one opinion. You say it with a lot more certainty than any opinion I would have on that. I don't really know how the economy is going to unfold. I don't even know how the health aspect of this crisis is going to unfold. So I think it's very difficult to pick a specific scenario and say, what do you think of that scenario? It's just you're in a period and as much as everyone would like to see first quarter results, where we say, here is the number. This is the impact of the crisis. We got that all figured out. It's just not possible at this point. It's just one of those situations where we're going to have to see how this unfolds over time. And as the impact evolves, our forecast will get more precise, and we'll be able to look back on it and say, this is the impact. But I think it's just too early to say that at this point.

Robert Wildhack – *Autonomous Research*

Okay. And maybe to just try to hit on the same theme in a different way. Is there any more color you can give us on how we can connect what you're seeing today, quantitatively, qualitatively, in the economy and in your borrowing base that can translate to the adjustments you've made to your collections?

Brett Roberts – *Credit Acceptance Corporation*

You'll have to ask that a different way. I didn't quite follow.

Robert Wildhack – *Autonomous Research*

Okay. We can follow up offline.

Operator

Our next question comes from Benjamin Weinger with 3-Sigma Value.

Benjamin Weinger – *3-Sigma Value*

I'm looking at your Board of Directors on your website and it's comprised of four members. I see Brett, the CEO, two guys affiliated with Prescott General Partners, which is your largest and longest-standing investor for over 20 years, and Glenda, who's been with you since 2004. I guess my question is that as a NASDAQ-listed company, what are the requirements for the independence of the Board of Directors? And specifically, for an Audit Committee?

Brett Roberts – *Credit Acceptance Corporation*

You'd have to look that up on the NASDAQ website. I don't know what that is off the top of my head. I'm sure that we comply.

Benjamin Weinger – *3-Sigma Value*

You're sure that you comply? How about, do you have anyone else on the line here who can confirm what the requirements are for independence?

Brett Roberts – *Credit Acceptance Corporation*

No, that's not, I mean, call your lawyer.

Benjamin Weinger – *3-Sigma Value*

Is your lawyer on there? Nobody knows?

Brett Roberts – *Credit Acceptance Corporation*

You're asking me a legal opinion. I mean, go look it up. I'm sure we comply.

Operator

Our next question comes from Giuliano Bologna with BTIG.

Giuliano Bologna – *BTIG*

One of the things that I think would be interesting to get some perspective on, one of the other tests in your bond indentures is your fixed charge coverage ratio, which has impacted more so on a cumulative basis looking back on a 12-month basis. But it really is measured with an EBITDA metric that's really on a GAAP basis. So if you saw another revision similar to the '08 scenario, you would probably trigger that, which would dramatically restrict your ability to take on any debt. Is there any kind of way to think about that covenant and how you could navigate around it?

Douglas Busk – *Credit Acceptance Corporation*

Are you referring to our senior notes?

Giuliano Bologna – *BTIG*

That's correct, yes.

Douglas Busk – *Credit Acceptance Corporation*

Yes. I mean, the covenants in the senior notes are based on the accounting that was in effect at the time of issuance for the first one—well, for both of them. So the operative GAAP there is the GAAP that we were operating under last year.

Giuliano Bologna – *BTIG*

That makes sense. And I guess one of the other things would be interesting to add a little bit of perspective on when we look at the securitization transactions, one of the levers that you do have is you have the ability to over collateralize certain transactions and effectively push more assets into certain transactions. Have you started doing that in any of the transactions at this point?

Douglas Busk – *Credit Acceptance Corporation*

We've done that on a limited basis.

Giuliano Bologna – *BTIG*

That makes sense. Then on a slightly different, on another different point. You have that table that Moshe was referring to around your collection rates. One of the things that I'm trying to get a little bit of perspective on there—it looks like your average loan balance, if I kind of run more of an average balance, is up 11% to 12% in the first quarter of this year versus the first quarter of last year. And then you have that kind of adjustment that, I guess, levelizes it, but it doesn't seem to kind of foot directly with the 12% number. And I'm assuming that's more so related to strong originations in the May time frame. But if we think about those numbers, with that in mind, it looks like 4.9% up is net; net may be down if your loan size is up 12% or so in that ballpark? And then as a second point, if I then look at a lot of the unemployment collections and the stimulus checks, most of that came in April, and you had some very large catch-up payments for a lot of the deferred and delayed unemployment checks. Do you think that had more of an impact in terms of getting delinquent borrowers to temporarily reperform? Or is the impact different in terms of your ability to get better credit performance?

Brett Roberts – *Credit Acceptance Corporation*

Yes. It's very difficult to say. I mean you had both of those occurring at the same time. You had customers that had missed their payments. You had the additional cash flow from the stimulus and potentially enhanced unemployment. And as a result of all those factors, we saw a rebound in collections in the last half of April and in May.

Giuliano Bologna – *BTIG*

That makes sense. Then the only other thing is thinking about originations. Is there any perspective on how you want to manage your originations going forward? And the main reason why I ask that is that if you continue up 20% versus last year, just the allowances alone could significantly impair your earnings stream and kind of get you closer to that fixed charges covenant, in my model at least, obviously, not your numbers. But I'd be interested in kind of seeing how you think about those types of impacts and would you go out and try and do some sort of consent to change any of the covenants?

Douglas Busk – *Credit Acceptance Corporation*

Yes, we don't want to have the accounting dictate how we run the business. We want to run the business looking at the economics of the business. So if running the business the right way would cause us to potentially encounter a covenant issue in our revolving credit facilities then we prefer to run the business the right way and have a conversation with our lenders explaining why that's the prudent thing to do.

Operator

And our next question comes from Thomas Shen with GoldenTree.

Thomas Shen – *GoldenTree*

In terms of repossessions, what are the kinds of things that you're looking for before you're going to feel comfortable going forward with that?

Douglas Busk – *Credit Acceptance Corporation*

Well certainly, one thing is in the several states that do have restrictions, you obviously want to make sure that those restrictions are lifted. I think the rest of that decision is a judgment call that we'll make internally. And we'll look at the degree to which the economy is open and people are employed in specific areas and try to make a subjective decision that is both right for ourselves and right for the borrowers. There's no scientific formula that would tell you precisely when you ought to start repossessing, and I don't think one approach works for everywhere.

Thomas Shen– *GoldenTree*

Would you go state by state?

Brett Roberts – *Credit Acceptance Corporation*

I think it's really -- it's a customer-by-customer decision. In a lot of ways, it's not much, not really different than what we have done historically. You're trying to work out an arrangement with the customer if you can, that keeps them in the vehicle. That's always the best case for the customer and for us. If there comes a point where the customer is just unable to pay for the vehicle at a certain point in time, you have to make the decision to repossess. The state by state certainly comes in if there is specific orders in a given state, we obviously would follow those orders.

Operator

Our next question comes from David Scharf with JMP Securities.

David Scharf – *JMP Securities*

Thanks for taking my questions; most have been answered. I was wondering if there was any color you could provide on the May volumes, obviously there is likely to be some pent-up demand included in that increase. But Brett, I'm wondering, do you get feedback from your dealers about, for lack of a better term, something the equivalent of a take rate? Obviously, you're on a different origination platform. But you had mentioned it may be a little too early to make any comments or conclusions about whether the competitive environment may be easing up. But do you get a sense whether or not in the May volumes your dealers were finding fewer alternative financing options and that competition may be easing?

Brett Roberts – *Credit Acceptance Corporation*

I mean you have in an anecdotal sense, but I'm reluctant to comment on the competitive environment until you have data that you can look at. You have pent-up demand. You have stimulus money. You have dealerships reopening. And potentially, you have a change in the competitive environment, but it's just too early to try to say how much each impacted the May volumes. I guess even if you concluded the competitive environment had gotten easier in May, you still wouldn't know how long that would last. So I'm not sure it would do you a lot of good.

David Scharf – *JMP Securities*

Got it. Obviously, we're all kind of grasping for early indicators. And I guess as just a follow-up; similar topic. Is there any anecdotal information to share on, I guess, the overall health of the dealer network, particularly the independents, maybe the roughly 2/3 of the base that are independents. Are you aware of any attrition thus far among independent dealers through the crisis? Or is it still early and most are hanging on?

Brett Roberts – *Credit Acceptance Corporation*

I think it's still too early to say there. I'm sure that like every business, or like most businesses, I should say, they're under a lot of stress because of the environment that we're in.

Operator

Our next question comes from Vincent Caintic with Stephens.

Vincent Caintic – *Stephens*

Two questions. First for that 6-month net income covenant. Could you let us know what are the exclusions or what are the takeouts from net income to come to that covenant?

Douglas Busk – *Credit Acceptance Corporation*

Basically, the biggest one would be nonrecurring gains or losses. So you've got a $7 million pretax number this quarter. There is a couple of other things that are less significant. But at the end of the day, based on the current quarter's results, those adjustments aren't really material.

Vincent Caintic – *Stephens*

Okay. That's helpful. Second follow-up. So I understand that forecasts are difficult. And the collections forecast is based at the end of March and CECL makes things even more volatile. But March volumes and payment collections were deteriorating, when I think about the disclosures you gave with May, it's getting a lot better. And so I'm wondering if we're using the data that we're seeing in May, could you actually see some of these numbers go in the positive direction? So meaning your forecasted collections being better than that 2.3% here you're forecasting currently? And then from a CECL basis, maybe going the other direction with a release.

Douglas Busk – *Credit Acceptance Corporation*

Conceivably, I think that, again, it's just too early to tell; a lot of variables out there. So as Brett said, I think it's really early. We'll just have to see how it goes. Certainly, results in the latter part of April and in May have been encouraging, but there are a lot of variables out there. So we'll just have to see how that plays out.

Operator

Our next question comes from Harold Levy with MCA Realty.

Harold Levy – MCA Realty

I just have one question on the financials. Looking at the cash flow statement, net cash from operating activities is pretty much equivalent to same time last year. So looking at the balance sheet, it looks like cash and cash equivalents have been drawn down significantly from $187 million to $25 million approximately. So I'm just trying to tie out those two things and what's caused the significant cash decrease in the quarter?

Douglas Busk – *Credit Acceptance Corporation*

I think the current quarter, if you look over a long period of time, is more reflective of how we've tended to run the business over time. We try to operate with less unrestricted cash as opposed to more because of the negative carry. And we rely on our revolving credit facilities as our primary source of liquidity. So I think the amount we were sitting on in cash and cash equivalents last year is unusually high just due to some financing activity that occurred in the latter part of last year.

Harold Levy – MCA Realty

Got it. That makes sense. And then on the cash flow statement, which just if I'm reading this incorrectly, that's fine. But the net cash isn't really impacted, but the cash equivalents have gone down so much in the quarter. So am I just missing something there? Or how does that tie with one another?

Douglas Busk – *Credit Acceptance Corporation*

I guess I don't really follow the question.

Harold Levy – MCA Realty

Okay. Just it looks like you guys utilized a lot of cash in the quarter for what you just—for deployment, which is great. And the net cash slightly increased with the adjustment. Obviously, on an unadjusted basis, it would be a large negative number. But with the adjustment, at the same time last year, it's pretty much the same or slightly higher. So I'm just struggling to understand how so much cash has been used, utilized effectively, I'm sure, but the net cash has increased slightly?

Douglas Busk – *Credit Acceptance Corporation*

Well, there were a couple of unusual, well, one unusual transaction that occurred during the quarter. And that's we repaid about $400 million in long-term debt. We also bought back about $300 million in stock during the quarter.

Operator

Our next question comes from Mark Hammond with Bank of America.

Mark Hammond – *BofA Merrill Lynch*

Brett, Ken, and Doug. I noticed there was an increase in the share of the mix rather towards more purchase originations. I was just wondering what the cause of that was for the first quarter?

Douglas Busk – *Credit Acceptance Corporation*

No specific reason. It could just be that franchise dealers got a little larger share of the consumer traffic during the pandemic. Franchise dealers, especially the larger franchise groups, tend to prefer the purchase program. So that may be the reason, although we don't know that for absolute certain.

Mark Hammond – *BofA Merrill Lynch*

Cool. Yes. That makes some sense. That's what happened. And then lastly, I know you mentioned stock repurchases. And since I am a high-yield analyst, I have to ask if you've ever considered repurchasing some high-yield bonds with both of them around 90 as of yesterday?

Douglas Busk – *Credit Acceptance Corporation*

Not really. Never say never, but I think our primary focus is investing in new loans and secondarily buying back stock, and we think that's the best use of shareholders' capital.

Operator

Our next question comes from John Rowan with Janney.

John Rowan – *Janney*

Thanks for the follow-up. Just connecting a couple of things you said, Doug. Why contribute more collateral on as you said, on a limited basis to some facilities if you aren't close to triggering an early amortization event? As far as I know, that is the cure for a shortfall in that 90% collection threshold?

Douglas Busk – *Credit Acceptance Corporation*

Well, you couldn't violate the early amortization test. So if cumulative actual collections were less than 90% of cumulative forecast, that would lead to an early amortization event. You couldn't cure that by contributing additional collateral. You would have to basically proactively contribute excess collateral to securitizations to avoid breaching that trigger in the first place.

John Rowan – *Janney*

So is that why you contributed excess collateral to, as you said, a limited number of facilities during the quarter?

Douglas Busk – *Credit Acceptance Corporation*

Yes. We contributed to the more recently issued securitizations. The reason being is they've been outstanding for a shorter period of time and have had less time to build up a cumulative cushion versus the forecast.

John Rowan – *Janney*

Okay. Does that create a liquidity event for you guys? If we continue to have negative revisions to forecasted collections, will you continue to build in additional collateral? And then with the potential breach of a covenant on the revolver, where, how does that end if you, in fact, need to lean back on your revolver for liquidity if you're losing in advance out of the ABS facilities?

Douglas Busk – *Credit Acceptance Corporation*

We have over a billion dollars in unused and unencumbered collateral at the current time. So we're in a very, very strong position in terms of excess collateral. All our securitizations are performing better than expected at this point. So at this point, the securitizations aren't a near-term concern. Very happy with the performance there. As you suggested, that minimum net income potentially may be a concern. And if it is, we'll have a conversation with the banks about it.

Operator

With no further questions in the queue, I would like to turn the conference 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

Thank you once again, this does conclude today's conference call. We thank you for your participation.