EDITED TRANSCRIPT

Q3 2021 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS:

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

CONFERENCE CALL PARTICIPANTS:

David Scharf; *JMP Securities LLC*
Moshe Orenbuch; *Credit Suisse AG*
Ray Cheesman; *Anfield Group, LLC*
Rob Wildhack; *Autonomous Research LLP*

PRESENTATION

Operator

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

At this time, I would like to turn the call over to Credit Acceptance Chief Treasury Officer, Doug Busk. Sir, you may begin.

Douglas W. Busk; *Credit Acceptance Corporation*

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Third 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 29.4% and 17.9%, respectively, compared to the third quarter of 2020.
- An increase in forecasted collection rates for loans originated in 2018 through 2021. This resulted in a $82.3 million increase in the forecasted net cash flows from our loan portfolio.
- Adjusted net income increased 31% from the third quarter of 2020 to $219.1 million.
- Adjusted earnings per share increased 48% from the third quarter of 2020 to $13.84.
- Stock repurchases of approximately 1.3 million shares, 8% of the shares outstanding at the beginning of the quarter.

At this time, Ken Booth, our Chief Executive Officer; Jay Martin, our Senior Vice President - Finance & Accounting; and I will take your questions.

QUESTIONS AND ANSWERS

Operator

Your first question comes from the line of David Scharf from JMP Securities.

David Scharf; *JMP Securities LLC*

First off, obviously, the entire industry is kind of struggling with the unique inventory issues and elevated used car values and affordability issues, so no surprise on the volume front. But I'm wondering if you can give a little color perhaps on your take on the health of the independent dealer network.

And in particular, as we look at the decline in active dealers, once again, it's obviously reflecting industry forces. But is that decline entirely related to just the volume and affordability issues? Or is there any attrition taking place among independent dealers that you're seeing right now?

Douglas W. Busk; *Credit Acceptance Corporation*

I don't think that we have any real unique insight there. Independent dealers come into business and go out of business all the time. I think the best way to understand what's happening from an attrition perspective would be to look at some industry data.

The problem with that is that, that's available on a lagged basis. So we'll be able to understand that better with the passage of time. But right now, I'm sure it's a challenging time to be an independent dealer, but exactly how they're faring and what levels of attrition there are, I think it's difficult to say.

David Scharf; *JMP Securities LLC*

Got it. Got it. And maybe just one follow-up. Once again, this is—maybe it's more of a qualitative question without a crystal ball. But obviously, the rise in used car values certainly impacts your borrower probably the most. And just looking at the average loan size in this past quarter, almost $27,000, it's about 10% above what it was just in the first half of the year.

As you think about just the affordability aspects of your borrower and obviously, stimulus wearing off in other areas of support, do you feel like we've kind of reached a ceiling where it's going to be pretty difficult to put somebody in a vehicle where they'll be able to be comfortable with their monthly payments beyond this $27,000 level? Or do you think there's room to go?

Douglas W. Busk; *Credit Acceptance Corporation*
I think it's, again, tough to tell. We certainly have payment-to-income criteria that we use when we underwrite the loans, as the industry does. As you point out, certainly elevated used car prices have made it increasingly challenging for our borrower. I think it's fair to say that further increases in used car prices will make it incrementally more challenging, but I think it's very difficult to say if this is the limit.

I think it's fair to say the higher prices go, it makes it incrementally more challenging. So there would be some relief for our borrower if used car prices went the other way. It's fair to say that. But I can't say, I don't think there's a cliff phenomenon that occurs.

David Scharf; *JMP Securities LLC*

Got it. Got it. No, fair enough. I mean, obviously, a lot of unprecedented events we're all living through right now.

Operator

Your next question comes from the line of Moshe Orenbuch from Credit Suisse.

Moshe Orenbuch; *Credit Suisse AG*

Great. Maybe to follow up on that. I think you kind of alluded to some of the steps you're taking to underwrite in a more —in a higher used car price environment. Any other steps that you're taking in terms of things that you're putting in place?

Douglas W. Busk; *Credit Acceptance Corporation*

We haven't made material changes to our underwriting process.

Moshe Orenbuch; *Credit Suisse AG*

Got it. Okay. I did notice that the yield or adjusted revenue, I should say, has gone up the last couple of quarters. And I think in the footnotes, it talks about that being a function of the strong collections at 24%. Is that a number that we would expect to pe rsist? Is there any way to put some parameters around that?

Kenneth S. Booth; *Credit Acceptance Corporation*

I think it's hard to tell if it's going to persist or not. It really depends on how long elevated collections remain —it's hard to predict how long that will go on. But collections have been really strong for us. As long as they continue, we'll see pretty high adjusted revenue.

Moshe Orenbuch; *Credit Suisse AG*

Got it. And the release notes stock options expense, is that going to be a regular quarterly amount? How should we think about that $14.7 million?

Jay Martin; *Credit Acceptance Corporation*

If you think about that expense, we didn't begin recognizing that until we received shareholder approval in July. So we received approval July 21st. So if you look at that number, that was about 70 days worth of expense for the third quarter. You can project that out, and then that would be what it is for the fourth quarter.

One thing I would point out there is that the first annual vesting installment of these stock options, we granted them first back in last December, is going to be compressed in this first annual period since we didn't begin expense recognition until we received shareholder approval, where the future years, that will be spread out more throughout the year.

Moshe Orenbuch; *Credit Suisse AG*

I see. So is that a calendar year? So you say Q3 and Q4 will be the amount that we would expect to see for the full year '22?

Jay Martin; *Credit Acceptance Corporation*

I think it depends because if you look at when the options were granted, the majority of them were granted last December. The re was another large grant in April. So it won't exactly be that amount going forward.

Moshe Orenbuch; *Credit Suisse AG*

Okay. We'll take it offline. We'll figure it out. I did notice, obviously, a very large repurchase amount in the quarter. It looks like you bought back through October 25 based on the front of the Q, maybe another 200,000 shares. How should we be thinking about the pace of repurchase given that volumes still looked light in October. So how should we think about that?

Kenneth S. Booth; *Credit Acceptance Corporation*

I think we're really just going to follow our standard approach to that. When we have excess capital, first, we look to have it invested in the business. When we've got opportunities to invest in the business. That's what we do.

Right now, obviously, with the originations being challenging, we've got adequate capital. So at that point, we return it to shareholders. So I would consider—we'd expect that to continue for a while.

Douglas W. Busk; *Credit Acceptance Corporation*

Relative to your question about stock option expense, there is a table on Page 41 of the Q that shows the expected amount of expense for the remainder of the year and subsequent years.

Moshe Orenbuch; *Credit Suisse AG*

Perfect. Okay. Haven't gotten there yet.

Operator

Your next question comes from the line of Ray Cheesman from Anfield Capital.

Ray Cheesman; *Anfield Group, LLC*

I have two today. Most of the big banks that have outstanding consumer exposure are also reporting terrific credit quality. And also, th ey warned us that over the next two to four quarters, they expect things to more normalize with the fall-off of various government support projects where they're turning back on other loan streams like student loans on February 1. As you kind of gut check 2022, wo uld you expect anything different to happen in your business or basically the same kind of, go back to the old rates?

Kenneth S. Booth; *Credit Acceptance Corporation*

I mean we don't have a crystal ball, obviously, so you don't know what's going to happen, but collections have been very stro ng, as you've seen in our last couple releases. It doesn't really seem logical that those will continue forever. When they fall off, I think it's harder to predict. But I would expect at some point collections to go back to more normal levels.

Ray Cheesman; *Anfield Group, LLC*

The other question I had was, that shift in the portfolio toward increased dealer loans versus purchased loans, do you feel like that changes the risk profile of the portfolio?

Douglas W. Busk; *Credit Acceptance Corporation*

Yes. Certainly, I think it changes it to a degree because on the portfolio program, we're sharing the risk on the loan with the dealer. So any shortfall in collections is substantially offset by a reduction in dealer holdback. The change in the percentage of the p ortfolio was relatively modest, so there hasn't been a significant derisking of the portfolio, but there's a reduction on the margin.

Ray Cheesman; *Anfield Group, LLC*

And if I may, just one more quickly. You said that you hadn't changed your underwriting standards. I am wondering if the fall -off in new assignments because look, I'll be honest, I'm looking for a car, and they told me I have to fly to Texas to get one, an d I live in Colorado.

The question is, did you guys ever play with—and I shouldn't use that term, we'll call it a technical term play—in order to generate some volume, you might adjust your pricing because of the support in the used car market to kind of moderate that risk in the next 1, 2, 3 years?

Kenneth S. Booth; *Credit Acceptance Corporation*
We're always running various Champion/Challengers to try to maximize our economic profit originated. So we do run various scenarios, and we attempt to price it appropriately, but we're not chasing volume, for example, or we're not hedging against something we really can't predict in the future.

Operator

Your next question comes from the line of Rob Wildhack.

Rob Wildhack; *Autonomous Research LLP*

More broader or strategic question, how do you think about the appropriate leverage level for running the business?

Douglas W. Busk; *Credit Acceptance Corporation*

What we're trying to do with the way we finance the business is make sure it produces a cost-effective result when the capital markets are wide open but also allows us to maintain level amounts of originations if capital markets were closed for an extended per iod of time. So that has really driven the way we've run the liability side of the balance sheet, operating with modest leverage and significant excess availability on our revolver. So it's kind of an output of an analysis that we do.

Rob Wildhack; *Autonomous Research LLP*

Okay. And then would you say that the degree of leverage that you have today, that would be characterized as modest and meet all those criteria, you have significant excess availability?

Douglas W. Busk; *Credit Acceptance Corporation*

Yes.

Operator

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

Douglas W. Busk; *Credit Acceptance Corporation*

We'd like to thank everyone for their support and for joining us on our conference call today. If you have any additional fol low-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.