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Q3 2022 Credit Acceptance Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 01, 2022 / 9:00PM GMT

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PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation Third 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 Third 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 29.3% and 32.1%, respectively, as compared to the third quarter of 2021.

A decrease in forecasted collection rates for loans originated in 2019 through 2022, which decreased forecasted net cash flows from our loan portfolio by $85 million or 0.9%.

Adjusted net income decreased 18.5% from the third quarter of 2021 to $179 million.

Adjusted earnings per share decreased 3.5% from the third quarter of 2021 to $13.36.

Stock repurchases of approximately 54,000 shares, which represented 0.4% 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) Our first question comes from the line of Moshe Orenbuch from Credit Suisse.

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

I guess I'm trying to think of a way to connect the slower level of collections that you're observing and what the changes are that you're making to your estimate of total collections, I think the number was roughly twice as large in Q3 as it was in Q2. And maybe could you talk about how to relate that to kind of your adjusted yield -- adjusted revenue as a percentage of adjusted capital?

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

Well, relative to forecasting, we always try to forecast collections as accurately as possible. And we price to maximize the amount of economic profit that we expect the loans we're originating will produce over time. In doing so, we certainly consider recent trends in loan performance. So we're basically taking all the information that we have at our disposal and using that to forecast loan performance. I think it's important to note that forecasting collection rates is obviously pretty challenging, so our business model is designed to produce acceptable returns even if loan performance is less than forecast. Having said that, the collection results during the quarter, together with recent originations, caused the adjusted yield to decline from where it was in Q3 of '21 to where it was last quarter. So the collection performance in the quarter did contribute to a reduction in the adjusted yield. Is there something I missed?

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

I guess I'm trying to think about the adjusted yield into Q4, given that the reduction in collections in Q3 was roughly double where it was in Q2. I mean, is it kind of linear? Like how do we think about that reduction in yield, it was something on the order of 100 some-odd basis points from Q2 to Q3.

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

I mean there are a few different moving parts there. Obviously, what happens to loan performance in Q4 and the expected return on recent originations would both contribute. But if you hold everything constant, the decline in the collection performance that occurred in Q3 would have a negative impact on the adjusted yield in Q4. But as I pointed out, there are a couple of moving parts there.

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

Right. Got it. And this has all kind of occurred in a roughly stable employment environment. Can you kind of think about how we should think about those rates if employment were to improve or if it were to deteriorate from here?

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

I think the best thing we can really look at there is our experience during the credit crisis. If you look at the 2007 loans, which were originated in a pretty challenging environment—a challenging competitive environment—which tends to hurt loan performance. And then they were serviced in '08 and '09 when the unemployment rate went from 5% to 10%. And we did miss our forecast, but we missed our forecast by somewhere between 250 and 300 basis points. Now I'm not saying that's what would necessarily occur this time. But during the great credit crisis, our loans performed pretty close to our expectations.

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

Got it, thanks. And last thing for me is, it looks like in the third quarter, your spread on new loans actually improved from the first half. Can you just talk about the underlying factors there?

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

Yes. It did improve about 100 basis points. We try not to get into specifics of pricing and forecasting changes for competitive reasons.

Operator

Our next question comes from John Rowan with Janney.

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

So I'm going to ask a different version of the last question. So your advance specifically in the third quarter was down a decent amount. The spread was up. Your average volume per dealer-partner was up. Those things typically have an implication, if you want to read the tea leaves, as far as the competitive environment, and so I'm wondering if you could comment on that. And maybe in this conversation, overlay what's going on in the ABS market, whether or not smaller issuers are having trouble accessing the ABS market with what's been a pretty volatile spread environment? And whether or not that's helping you competitively? I know it's a loaded question, but I feel like all those intertwine and we could have a discussion on it.

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

Yes. I think you're right. I don't know exactly what's in the minds of all the competition. But obviously, conditions in the ABS market have been challenging as of late. Both base rates have increased and credit spreads have increased, particularly for subordinate bonds. So it wouldn't surprise me if people have reacted to that and are pricing their product somewhat differently than they were six months ago, say.

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

And I guess one of the competitive advantages that you have had in prior disruptions, particularly with the ABS market, is the ability to continue to access it. I'm wondering where do you think your spreads are going? Forget the changes in benchmark; that is what it is. But do you think your spreads are going to continue to widen out? How do you see your ability to access the ABS market?

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

I don't know what's going to happen to our spreads in the future. I mean it's just a function of capital market conditions. Certainly, we think we present a compelling credit profile for investors. But if you go back to the great credit crisis, there was a period of time when no one was able to access it, so I think it really just depends on how challenging capital market conditions become. I think we obviously did very well during the credit crisis. And I think a lot of that, despite being unable to access the ABS market for a period of a year or so, a lot of that was just the way that we positioned ourselves. And the same is true today. We have a conservative balance sheet with modest leverage, have a significant amount of unused availability on our revolving credit facilities. So I can't say what's going to happen in the ABS market, but I like the way that we're positioned at the current time.

Operator

Our next question comes from the line of Robert Wildhack with Autonomous Research.

Robert Henry Wildhack ***Bernstein Autonomous LLP - Analyst of Payments and Financial Technology***

Doug, I just wanted to double click on something you said. When you hold everything else constant in the third quarter, forecasted collections would have a negative impact on fourth quarter adjusted yield. Is that a one-time effect, as in the fourth quarter adjusted yield would be lower and that's it? Or does that trickle in over the life of the portfolio or loans or anything like that?

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

Yes. Since we're recognizing revenue on a level yield basis on our adjusted accounting, if loan performance didn't change after Q3, that lower yield would be realized in Q4 and subsequent quarters.

Robert Henry Wildhack ***Bernstein Autonomous LLP - Analyst of Payments and Financial Technology***

Okay. Got it. Got it. And then just one more on competition. Subprime auto broadly has been a soft spot, consumer credit for a little bit of a while now. Do you get the sense that accelerating losses are causing competitors to pull back? Or is it more funding cost driven?

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

I don't have perfect insight into that. My understanding is that credit in subprime land has generally normalized over time. It's certainly not as good as it was in '20 and '21. But I'm not close enough to what our competitors are seeing to comment beyond that.

Operator

(Operator Instructions) Our next question comes from the line of Jason Hahn with Principal Global Investors.

Jason Hahn ***Principal Global Investors, LLC - Senior High Yield Analyst***

This maybe piggybacks just a little bit off the last question, but we look at a lot of different metrics for your companies, but one of the ones we look at is just to gauge the overall financial health is just debt to cap, and that ratio is kind of ticked up to about 75% for the last few quarters. And then in terms of your funding mix, in terms of debt, we look at your senior unsecured debt to your secured debt, and that number tends to bounce around, I don't know, 20% or so for the last few quarters as well. And I guess just as you've seen the origination market turn and pick up pretty meaningfully, is there a target funding you have for each incremental dollar of sales? Or is there an upper bound on where that debt to cap or that senior unsecured to secured funding ratio might trend over the next few quarters?

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

We don't have specific targets for either debt to cap or as I think of debt-to-equity or the mix of unsecured to secured. The way that we approach it is we take a look at different financing strategies and look at sets of financial projections and try to come up with a funding strategy that produces a good result when the capital markets are open and accommodating, and produces an acceptable result when capital market conditions are more challenging. So we don't have specific targets, but we're certainly considering risk and refinancing risk as we're making our decisions there.

Obviously, the leverage has ticked down this quarter. That's really just due to the fact that we're deploying more capital into funding the growth in loan originations as opposed to repurchasing shares. So that's caused our leverage to moderate a little bit. It's worth pointing out that the leverage that we're looking at today is not directly comparable to what it was prior to January 1, 2020. You have 2 different methods of accounting here. And I think our leverage on our pre-2020 accounting is about 2.5 to 1. So that would still be kind of roughly at the high end of the historical range, but it's obviously lower than on our current accounting.

Jason Hahn ***Principal Global Investors, LLC - Senior High Yield Analyst***

Sure. No, that accounting change, that's fair because that definitely had a significant impact. I just didn't know if there was just an upper bound on that ratio where there was a comfort level or a lack of comfort for management, but your answer is helpful.

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

Yes. I mean there's not a hard and fast rule, but look at our track record, we've run the company pretty conservatively for a long period of time. And I think you should expect that to continue.

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'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 does conclude today's conference. We thank you for your participation.