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 Second Quarter 2014 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: Thank you Sam. Good afternoon and welcome to the Credit Acceptance Corporation Second Quarter 2014 Earnings Call. As you read our news release posted on the Investor Relations section of our website at 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 Adjusted 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: Ladies and gentlemen, if you have a question at this time, please press star then one on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key. And I'll give everyone a moment.

Our first question comes from the line of Brian Gustavson from 1060 Capital. Your line is now open.

Brian Gustavson: Hi and thank you for taking my question. I'm just curious if you could address the slowdown in loan volume in the quarter versus the last few quarters, you guys were in the low to mid-teens now you're in the mid-single digits. I know you talk about more competition. I would just like some more color on that. Thank you.

Brett Roberts: It continues to be a difficult competitive environment. The growth rate in the second quarter did break the trend that we saw over the last three quarters. I don't know if the comparison is a little bit tougher this quarter. Last year's first quarter was pretty soft, so the first quarter of this year's growth number likely reflected that. The comparison was a little bit tougher. But it continues to be a very tough market, and the 4.5 percent growth that we had this time was certainly a break in the trend line.

Brian Gustavson: Do you see the competitive environment getting any better? How is July looking? Any change to what you've been seeing so far in the first half?

Brett Roberts: It will get better at some point but it goes in cycles. It's probably likely to get worse before it gets better. That has been the history. It is difficult to know the exact timing, but we're in a period now where there's lots of capital and there's lots of competition, and there's certainly loans that are being written that we wouldn't want to write based on the economics of those loans, and so we just have to be patient until the tides turn which they eventually will.

Brian Gustavson: Got you. And when does the slower loan growth hit the income statement to cause slower earnings or slower revenue growth? What is the average length of a loan?

Douglas Busk: The average length of a consumer loan is about four years. But again, the asset that we put on our balance sheet and the asset that drives our revenue recognition is the amount that we pay to the dealer.

Because of the relationship between what we pay to the dealer and the cash flows on the loan, and the fact that we recover our investment before the dealer receives any residual interest, the life of our investment in the loan is much shorter, roughly in the neighborhood of a couple of years. So we've been growing at, in 2012 we grew mid-single digits, 2013 we grew mid-single digits. So I would say that a lot of the impact of the slower growth is already reflected in our current income statement.

Brian Gustavson: Got you. I'll let someone else ask a question.

Operator: Our next question comes from Robert Dodd with Raymond James. Your line is now open.

Robert Dodd: Hi, guys. First of all, in the 10-Q there is a disclosure that you got an inquiry or an investigative demand from the Federal Trade Commission, is there anything more you can tell us about either what's in that letter in terms of what they are particularly looking at, or you expect a time line for that issue to be resolved?

Douglas Busk: Relative to the contents of the civil investigative demand, it requested information on a number of topics: credit reporting, consumer privacy and information security, customer payments, marketing, training, customer communications, and consumer complaints. In terms of timing, really we don't have any insight there. We provide information, and the next step and the timing of the next step isn't known.

Robert Dodd: If I can ask a separate question, and I'll hop back in the queue. You talked about the tougher competitive environment, which obviously isn't something particularly new. If I look at the advance rates that you've been giving to dealers as they continue to tick up a little bit in the second quarter, the average in the first half is running a little bit above what it was for the first quarter obviously, so it was continuing to see upward movement in how much you're willing to fund to a dealer. Do you have any visibility on when – if that's going to stabilize, or where kind of that peak point is that you would be willing to advance to a dealer and still generate the kind of returns on capital that you expect?

Brett Roberts: With respect to the portfolio program where we generate 90 percent of our business we haven't made a pricing change there since September of 2012. So we're holding the line on pricing there. In the table you see a column for forecasted collections, a column for advances, and then a spread. And if you look at the difference between 2013 and 2014 in terms of the spread, which is probably the best number to look at, there is about a 100 basis points decrease in the spread. But you have to keep in mind that in 2013 and for most of the years in the table after we booked the loan there's been an increase in the forecasted collection rate which has occurred over time, and assuming 2014 has the same positive variance as 2013, those spreads will be pretty much the same.

So the 100 basis point decrease in spread just reflects the fact that we had a positive variance on 2013 originations, whether we have one in 2014 or not I don't know, but if we do it will be about the same. With respect to the purchase program we have gotten a little bit more aggressive there, and those numbers will show up in the table. If we advance more our return goes down, so there's not a point where we can advance and keep the same return. It's dollar for dollar. If we advance the dealers more money, our return goes down. So the way we try to optimize that equation is we always do it the same way, whether it's competitive or not competitive, we're always trying to maximize the total unit volume times the profit per unit, and that's the way we price.

Robert Dodd: I appreciate it. Thanks, guys.

Operator: Again, ladies and gentlemen, if you have a question at this time, please press star then one on your touchtone telephone. Our next question is from Jason Stewart with Compass Point. Your line is now open.

Amy DeBone: Hi, this is actually Amy DeBone sitting in for Jason. Congrats on the good quarter, and thanks for taking our questions. Most of our questions have actually already been answered but in terms of the other income, there was a slight decline that came in below our estimates this quarter and I was just wondering what was driving that decline?

Douglas Busk: Other income was roughly consistent with the same quarter in 2013. You may be referring to the decline from the first quarter of 2014. If so, the decline was due to a reduction in fees earned that we receive when dealers sell a GPS-SID device, that's just due to seasonality and lower penetration rates. It was also due to a decrease in vehicle service contract profit sharing income.

Amy DeBone: Would you expect other income to be similar to the levels seen in 2013 on a quarterly basis?

Brett Roberts: Both of the things that Doug talked about in Q2, about the lower penetration on the GPS-SID and the lower profitability on the VSCs, those are both likely to continue for some time.

Amy DeBone: In terms of share count, share count went down pretty significantly this quarter. Is that a trend that you'll see further in the year?

Douglas Busk: Well, the reason that the share count went down this quarter is that we did a stock buyback at the end of the first quarter that due to the timing of it had very little impact on the number of shares outstanding in Q1, but had a more material impact on the shares outstanding in Q2. We'll have a similar phenomenon going on in the third quarter this year because we completed a buyback of approximately 900,000 shares in mid-June that modestly impacted the share count for the second quarter but will reduce the share count by approximately 760,000 shares in the third quarter.

Amy DeBone: Last question, in terms of the difference between adjusted earnings per share and GAAP earnings per share, the deferred losses related to the February 2014 debt extinguishment, is that adjustment something that we will see throughout 2014 – 2015? It sounded, in the release, like that adjustment will continue?

Douglas Busk: That's correct.

Amy DeBone: That is a charge that will continue for the next five years?

Douglas Busk: Yes, through the term of the 2021 senior notes.

Amy DeBone: OK. Great. Thank you so much.

Operator: Our next question comes from Kyle Joseph with Jefferies. Your line is now open.

Kyle Joseph: Afternoon, guys. Thanks for taking my questions. Most of them have been answered. Collections on the 2014 loans, I know it's early already, but it looks like your collections improved a fair amount already. Can you explain a little bit about what's going on there? Is it just general macro economic improvement, or something specific in that vintage?

Brett Roberts: I think that the trend for 2014 is very similar to the trend in 2013 originations. So no real big change there.

Kyle Joseph: Thanks for answering my question and congratulations on a good quarter.

Operator: Our next question comes from Ken Bruce with Bank of America. Your line is now open. Ken, your line is now open.

Ken Bruce: Sorry about that. Can you hear me?

Douglas Busk: Yes.

Ken Bruce: OK. Good afternoon, or good evening. What are you doing to address the new active dealers just as you kind of look over the last few quarters, it looks like at least based on the increase in the sales force that you did back in 2012, it may have kind of run its course down pretty significantly just on a quarter-over-quarter basis, which may be partly seasonal, but it looks like we have seen a little bit of an inflection. How should we be looking at that?

Brett Roberts: I think you're right. I think we had a nice trend for many quarters in a row of increasing the active dealer count. That changed this quarter. We still feel like we've got a big market out there. But it's very, very competitive, and it shows up not only in volume per dealer, but it's tougher to sign up new dealers, as well.

Ken Bruce: Right. And do you think that at this point it’s back to having to add more sales people? I think back a year or so ago you felt pretty comfortable that you could basically cover the footprint that you wanted to with the sales force that you had, is there any change in thought in terms of how you can address to regrow the market?

Brett Roberts: No, I think we have more work to do in getting the existing sales force more productive. I don't think expanding it at this point is something we're looking to do.

Ken Bruce: OK. Anything else that you could do in terms of trying to improve the general volumes? I recognize that just looking, considering what is going on in terms of the competitive backdrop, you probably want to be careful about changing anything from a pricing or structure standpoint, but is there, do you feel like there's anything you can do at this stage to maybe regain some of that momentum?

Brett Roberts: I think you should look at the comparisons. I'm not sure the second quarter was much different than the first. It had more to do with the comparison than anything else. If you compare the 2014 volumes to the 2012 volumes you would see second quarter looked a lot like the first quarter. We would always like to grow a little bit faster, but I think as a shareholder you should be more concerned if we were going at 35 percent this quarter than at 4.5 percent, because it's just a real tough market out there.

Ken Bruce: Agreed. I guess I'm really just trying to maybe anticipate what actions you may take, and whether it would be trying to drive the growth or if you just do more buybacks just in order to drive the bottom line economics?

Douglas Busk: We continue to work on improving virtually every aspect of our business. I don't think there's any, we're not really willing to make wholesale changes on pricing or policy at this point, which is the easiest way to improve volume, but obviously have a very negative impact on per loan profitability. I don't think that there's any silver bullet out there that's going to make a dramatic improvement in volume in the near-term. I think, as Brett said, it's a tough competitive environment and at some point it will become more favorable but until then we're just going to focus on executing to the best of our ability.

Ken Bruce: OK. And maybe just lastly, is there anything just in terms of where the competition is coming from? Is it new entrants or is it more traditional players that have been in the market and have just decided to essentially pay up for loans at this point?

Brett Roberts: It's a little bit of both. It's mostly the larger players that make a difference. There are like 25 to 50 reasonable sized players that are out there and some of them are getting pretty aggressive.

Ken Bruce: OK. Thank you for your comments. Appreciate it.

Operator: Once again, if you have a question at this time, please press star then one on your touchtone telephone. Our next question comes from Brian Gustavson with 1060 Capital. Your line is now open.

Brian Gustavson: Hi, just on the FTC inquiry, I'm wondering if you have received one before in the past and how that affected the business?

Douglas Busk: We have not received one before.

Brian Gustavson: OK. And just on the timing, I think you said you got it on June 6th, you had a tender offer I think that expired on June 16th, and I don't know how materially you view an FTC inquiry but I'm wondering about the whole decision-making process especially in light of the large insider selling that took place with that tender? Thank you.

Douglas Busk: We discussed the matter internally. We did discuss it with counsel. The contents of the civil investigative demand are relatively straightforward and benign, and after discussing it internally with counsel, we didn't think really there was anything to disclose.

Brian Gustavson: OK. Thank you.

Operator: And our final question comes from the line of Moshe Orenbuch from Credit Suisse. Your line is now open.

Moshe Orenbuch: Great. Thanks. Just a follow-up on the question about increased competition. You mentioned specifically that there were loans that were being made that you wouldn’t make. Would you say those are being made by typically the larger players or just smaller players? Could you talk about that, as to whether there is anything there?

Brett Roberts: I'm not going on get into specific names of who is doing what, but it's a story we've seen before. We've been through the cycle several times. Our returns are, the returns that we try to make, our target returns are quite a bit higher than the target returns of a lot of the companies we compete with. If everything goes according to plan, the profit per deal that we shoot to achieve is typically quite a bit higher in terms of returns, and you can look at the other public companies that are out there that are auto finance companies, and compute their returns, and you can corroborate what I'm saying. But then usually there's a part of the cycle where things don't go according to plan, and because we have a nice margin of safety built into our business model, we typically do OK during those periods, and there are other companies that operate with razor thin margins, that don't do as well. And we would expect it to play out the same way this time.

Moshe Orenbuch: So is it fair to say from that standpoint that you are almost rooting for weaker used car values? I mean how important is the level of used car values to both your ability to grow and your competitor's ability to compete against you?

Brett Roberts: As much as we can, we try to think long-term, and we know that over the next 20 years there are going to be periods that look a lot like 2014, and there will be periods that are quite a bit easier, and what we expect over the next 20 years is a mix of the two. So we try not to worry about the timing of when one cycle starts and the other one ends, because we know we have to compete and be successful in both environments. Obviously we'll make a lot more progress faster in an easier environment, and we expect we'll have one of those in the next 20 years. But we try not to worry too much about what happens this month, or this quarter, or when will this end. We just keep focusing, as Doug said, on making every part of our business better and that will make us the most money in every part of the cycle.

Moshe Orenbuch: Alright. OK. Can you just mention whether there's been any kind of discussions with the CFPB over the course of the last quarter?

Douglas Busk: We haven't had any formal discussions with the CFPB. Our Chief Legal Officer is a member of the Board of AFSA, so in that role he certainly has had conversations with them and is obviously aware of what is going on in the industry. So Charlie Pearce is very tuned in to things.

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 Busk: 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.

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