# CREDIT ACCEPTANCE CORPORATION

## Moderator: Douglas Busk
## July 30, 2020
## 5:00 p.m. ET

**Operator**

Good day, everyone, and welcome to the Credit Acceptance Corporation Second 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 Chief Treasury Officer, Doug Busk.

---

**Douglas Busk** – *Credit Acceptance Corporation*

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Second 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 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. We understand that our 10-Q is not yet available. Consistent with past practice, we submitted the 10-Q to the SEC at the same time we released earnings. Its release is delayed due to technical difficulties at the SEC that are preventing it from accepting filings from any company.

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 is from Moshe Orenbuch from Crédit Suisse.

---

**Moshe Orenbuch** – *Crédit Suisse*

Great. I guess, could you talk a little bit about when you made the cash flow assumptions this quarter, how did you take into account what's likely to happen given that as it stands today, stimulus ends tomorrow, could be renewed, could be renewed at the same/different level? How did you kind of take that into account as you look forward?

---

**Brett Roberts** – *Credit Acceptance Corporation*

So in the first quarter, if you remember, we had a $44 million unfavorable change to our forecast that reflected just the forecasting model reacting to what happened in the first quarter. And then, since the forecasting model doesn't know that there's a pandemic or that we're in a period of economic disruption, we took an additional roughly $160 million write-down to account for what we expected would be a difficult period from a loan performance perspective. So the $44 million, you could think of as a mechanical result and $160 million was largely subjective. This quarter, we didn't make any additional subjective adjustment. We gave you some collection numbers you can look at; generally seeing favorable trends there. We just let the forecasting model spit out the result, and that's what we booked to.

---

**Moshe Orenbuch** – *Crédit Suisse*

Right, Brett. But I guess I was asking how the forecasting model looks -- I mean, what are the inputs? Does it look at… I mean, what are the inputs?

---

**Brett Roberts** – *Credit Acceptance Corporation*

Well, the forecasting model's been in place for many, many years. It's an empirical scorecard-based approach, where it looks at many attributes of a loan and then forecasts future cash flows based on the historical performance of similar loans. And so that part hasn't changed. But it doesn't have macro factors in there, like when are they going to -- to what degree are they going to pass another stimulus bill. It doesn't have unemployment in there. It just looks at the historical performance of similar loans based on variables that we capture either at origination or throughout the servicing process.

---

**Moshe Orenbuch** – *Crédit Suisse*

I just want to make this clear. You said it doesn't take into account unemployment rates at -- or the likelihood that that borrower… I mean, how do you assess the likelihood that that borrower will continue to pay then?

---

**Brett Roberts** – *Credit Acceptance Corporation*

I think it's just what I said.

---

**Douglas Busk** – *Credit Acceptance Corporation*

It's based on the performance of loans with similar attributes and characteristics.

---

**Moshe Orenbuch** – *Crédit Suisse*

But it has nothing to do with the current state of the economy?

---

**Douglas Busk** – *Credit Acceptance Corporation*

Correct. That's correct

---

**Brett Roberts** – *Credit Acceptance Corporation*

The subjective adjustment, as I described, is intended to take that into account.

---

**Moshe Orenbuch** – *Crédit Suisse*

Right. And you reversed part of that subjective adjustment, right? Now that you took that back into income?

---

**Brett Roberts** – *Credit Acceptance Corporation*

No, I'm not sure if you're listening. So we didn't make any additional subjective adjustment in the second quarter.

---

**Moshe Orenbuch** – *Crédit Suisse*

Right. And I'm looking at the front page of the press release. There was a remaining reversal of provision of credit losses of $14.8 million in the quarter, that's what I was referring to.

---

**Brett Roberts** – *Credit Acceptance Corporation*

Yes, so that's the CECL adjustment. So we're just talking about the change in the net cash flows here.

---

**Moshe Orenbuch** – *Crédit Suisse*

Got it. Okay. I see. And how was that number, that $14.8 million computed?

---

**Douglas Busk** – *Credit Acceptance Corporation*

The $14.8 million is the change in the present value of the expected future net cash flows. Let me say it differently. It's the amount of expense required to reduce the loan asset to the present value of the expected future net cash flows. So collections less dealer holdback. In this case, it wasn't an expense. It was a reversal.

---

**Operator**

(Operator Instructions) Our next question is from John Rowan from Janney.

---

**John Rowan** – *Janney*

Did you have to contribute any cash to any of the ABS facilities this quarter? Or not cash, any collateral?

---

**Douglas Busk** – *Credit Acceptance Corporation*

No.

---

**John Rowan** – *Janney*

And then was there any discernible shift in the credit profile of your borrowers given that you went out another month and the loans this quarter were up to 59 months in duration?

**Douglas Busk** – *Credit Acceptance Corporation*

No.

**John Rowan** – *Janney*

Okay. I mean, why go out further in duration when, obviously, the outlook for the next couple -- at least next year is certainly a little uneven given the pandemic? And that's it for me.

**Brett Roberts** – *Credit Acceptance Corporation*

We didn't change our program during the quarter. So we offer a variety of loan terms. And it's the customer that selects the vehicle along with the dealer and the loan term that matches their desired results. So we don't necessarily control the average loan term.

**Operator**

(Operator Instructions) The next question is from Giuliano Bologna from BTIG.

**Giuliano Bologna** – *BTIG*

To just kind of dig back into the model question a little bit. One of the things I was curious about was you were saying that it kind of goes back and looks at the statistical model that you use. And I was kind of curious from an accounting perspective, because you elected CECL, is there any requirement to use an economic forecast in the estimates that you use on a forward basis? Or are you using a little bit of a different framework there?

**Douglas Busk** – *Credit Acceptance Corporation*

No, there's no requirement.

**Brett Roberts** – *Credit Acceptance Corporation*

It's supposed to be your best estimate. And if you go back, we've been forecasting for many years. We've taken a number of runs at including unemployment data in the actual forecasting model. And it just doesn't help the accuracy of the model is what we've found historically. We went to even local unemployment data to see if we could figure out how to use that information to forecast more accurately, and it just didn't work. So if it was possible, we'd do it if it made it more accurate. But since it doesn't, we've just treated that like we did in the first quarter as a subjective adjustment, very similar to what we did during the financial crisis. We made an adjustment of a similar magnitude. And actually, in retrospect, it turned out to be pretty accurate. It doesn't mean this one will. I think, I probably should emphasize like we did last quarter. We're in the early stages of this. There's a lot of uncertainty. I don't think you should look at our forecast either at the end of the first quarter or at the end of the second quarter as a hard number. It's an estimate, and I think we've stressed that there's a lot of uncertainty around that.

**Giuliano Bologna** – *BTIG*

That makes sense a lot of sense. What I'd be curious about is, how are you kind of planning or adjusting your business for the potential roll-off of some of the stimulus? And are you thinking about putting in place different programs to provide support to customers if they run into more trouble? Or how do you think about how to operate your business, given the uncertainty around unemployment, additional unemployment benefits, and other things of that nature?

**Brett Roberts** – *Credit Acceptance Corporation*

It's really what we've always done, so we've tried to run our business in a conservative fashion. We know that predicting the future is difficult. We don't expect it to always turn out like we planned. So we've been through lots of challenges over the years and the conservative approach is the only one we know, and that's the one we're going to continue.

**Operator**

Your next question is from David Scharf from JMP Securities.

**David Scharf** – *JMP Securities*

A couple of things. One is, I know in the past, you've mentioned that used car values have not had a material impact on kind of your all-in returns. Just given that the Manheim -- that used car values are at such high levels at least at the end of June, can you just give me a 30-second tutorial again, why that shouldn't impact the net returns on the portfolio, particularly given the degree to which you repossess?

**Brett Roberts** – *Credit Acceptance Corporation*

Here's how I would think about it. So if you originate a loan today, maybe it's a 60-month loan or a 48-month loan. Some of the loans that you originate, you're going to end up repossessing. And on the day you sell that collateral, it matters what the market is. In a good market, you'll get a little bit more money, in a bad market you'll get a little bit less. But what happens over the course of the 60-month loan is you'll go through ups and downs, probably 3 or 4 of them. And at some point in that spectrum, you'll get lucky and the market will be good. At other points, the opposite will happen. And so typically, if you just look at 1 month's originations, it sort of evens out. And so the way we look at it is we kind of track the values and look at the depreciation curve. And if you look at it over 18, 24, 30-month period, there's not nearly as much volatility as the way people look at the Manheim Index, which obviously changes every month. So that's one factor. You tend to have ups and downs and it evens out over a period of time. And then the other factor is repossession proceeds just aren't a huge portion of the total cash flows. Most of the cash that we collect comes from customers making their payments. So the combination of those 2 things mean that for us, used car values aren't a critical variable. I mean, yes, sure, it matters to some extent. But because it evens out and because it's not a huge percentage of the cash flows, it's not as important as people perceive it to be.

**Douglas Busk** – *Credit Acceptance Corporation*

I guess one other thing I would add there is on the portfolio program, 80% of the increase or decrease in the value of the vehicle either increases or decreases the amount of dealer holdback. So the fact that we're splitting the collections on the loan with the dealer provides some insulation for us in terms of variation in vehicle prices and other factors that impact loan performance.

**David Scharf** – *JMP Securities*

Got it. Got it. It sounds like level-yield accounting allows for the short-term fluctuations in values to get kind of smoothed out over time or it just doesn't impact it as much. Understood. That's helpful. I'm wondering -- I'm not sure if it was addressed in the last question. Just in terms of forbearance and deferral trends, obviously, for pretty much every consumer lending asset class, the percentage of accounts in some sort of deferral program peaked sometime in April or May. Can you give us a sense for how that's trended throughout the quarter? And maybe some context of maybe a year ago, sort of what's the typical percentage of accounts that are in some type of forbearance or deferral program?

**Brett Roberts** – *Credit Acceptance Corporation*

Sure. So we—like we always do—work with customers that are having difficulty making their payments. The objective is to keep the customer in the vehicle. It's good for the customer, it's good for us. The reason we disclose the year-over-year change in cash collections and broke out the front end collections is, it's really a simple way to see how the pandemic is impacting our results on a monthly basis. So if you look at those numbers, it tells a pretty clear story. We started out in January, which is kind of your baseline, January and February. The results suffered in March and April, started to improve pretty dramatically in May and that's continued through the last date we gave you, which is July 28.

**David Scharf** – *JMP Securities*

Okay. And I know I don't have those numbers right in front of me, but are they getting close to sort of pre-pandemic levels, percentage wise?

**Brett Roberts** – *Credit Acceptance Corporation*

Well, I think, right now they're better than pre-pandemic levels. And if you can look at kind of January, February as your baseline, we're doing better than that. I think the opposite side of that is it's very early. And as other people pointed out, there's been federal stimulus. There's been enhanced unemployment. There's no certainty that that's going to continue or we don't know how long it will continue even if it does. So early innings, things look pretty good. I think if you'd asked me back in March, if I thought we'd be in this good a position, I would have said no. So we're pleased about that. But also keep in mind that it's very, very early, and this is going to play out over a long period of time.

**David Scharf** – *JMP Securities*

Got it. And then lastly, just in terms of maybe -- well, pricing and overall returns, stop me if this is a too simplistic way of looking at things. But instead of looking at all these different vintages, every quarter I just divide finance charges by your average balance for the quarter to get a gross yield, which is obviously that level yield that is kind of the average of all of the different static pools that you forecasted. At least this quarter, it looks like when I calculated the yield on a simple average, it is 22.6%. And it's actually -- that's the highest in about 5 or 6 quarters. Did you see anything in the pricing environment or just the demand environment? Or how much independent dealers were willing to accept in terms of holdback? Is that an accurate calculation directionally that you're forecasting your portfolio to generate a higher yield, whether it's...

**Brett Roberts** – *Credit Acceptance Corporation*

No, it's not. So I think what you probably did is you took the GAAP number. And so you got to remember with CECL, that GAAP finance charges are higher than what our economic yield really is. So you have to start with the adjusted numbers. And what you find there is just like you would expect, when we reduced our cash flow forecast in March, the yield dropped. And we got a portion of that back during the second quarter, but it's still lower than it was pre-pandemic. If the cash flow forecast recovers, the yield will recover over time. And if it doesn't, then the opposite. But no, the yield only increased for GAAP in the world of GAAP, but I wouldn't…it's difficult to figure out what the economics are if you're looking at it through that lens.

---

**David Scharf** – *JMP Securities*

Right. Okay. No, thanks for the clarification because it was obviously counterintuitive.

---

**Operator**

Our next question is from David Feller from Wells Fargo.

---

**David Feller** – *Wells Fargo*

I wanted to follow up on the prior question about just used car prices overall. You've obviously seen those bounce around. What are you guys thinking internally about used car prices for the year? Just seeing a number of different retailers and players in the auto space give various different estimates, so I wanted to hear your view.

---

**Douglas Busk** – *Credit Acceptance Corporation*

We don't really have a view.

---

**David Feller** – *Wells Fargo*

Okay. And then I appreciate all the color on the month-by-month changes in collections, both front end as well as total collections. As you look at the March and April data and the decline there, is there any way to think through how much of that was more driven by the auctions being closed versus just overall kind of collections on payments from customers? In other words...

---

**Brett Roberts** – *Credit Acceptance Corporation*

The front end collections would reflect payments from customers. Total collections reflect all cash flows. So that's why we broke it out into two columns so you could assess the different trends between those two numbers. Clearly, we weren't selling cars at auction so total collections are going to be impacted. That doesn't impact front end collections, though. So we broke that out separately so you could see that.

---

**David Feller** – *Wells Fargo*

Got it. And the prior question where you talked about it getting back to pre-pandemic levels. What are kind of the major drivers there of the year-over-year growth?

---

**Brett Roberts** – *Credit Acceptance Corporation*

So in January and February, I'd say, those were unaffected because that was pre-pandemic. You go through March, April and May, and you saw the impact of the pandemic and then June and July, you see better results. So we're really starting in May. May, June and July, you see better results, which likely reflects to some extent the impact of the stimulus money and the enhanced unemployment benefits.

---

**David Feller** – *Wells Fargo*

Okay. Could you talk about regional performance at all? And maybe talk about where you have higher exposures in terms of geographical exposure?

---

**Douglas Busk** – *Credit Acceptance Corporation*

We really aren't going to talk about anything beyond what we've already disclosed. We have disclosed in our 10-Ks where our top 5 states are. So you can take a look at that and draw some conclusions about what's going on from an economic perspective in all of those states. But we're not going to disclose anything beyond what's in the release and what will be in the 10-Q when it gets filed.

---

**David Feller** – *Wells Fargo*

Okay. And then just last question for me. The decline in active dealers, can you just talk about major drivers there? And are you guys expecting any major overall changes in the industry in terms of dealer closures through the end of this year or maybe into 2021? Or do you expect it to be more muted?

**Brett Roberts** – *Credit Acceptance Corporation*

I think you saw the active dealer count decline year-over-year this quarter. Attrition was, if you look at it in terms of the number of dealers, attrition was about average, maybe a little bit better than average. The difference from prior quarters is we just didn't have as many new actives as we have had historically. Part of that might be that our sales force was largely working from home. But the trends in new actives and new actives per MAM haven't been great. They were declining before the pandemic but you just see -- you saw a continuation of that in the second quarter or a worsening of that in the second quarter, probably partially related to the fact that the MAMs were working out of their house.

**David Feller** – *Wells Fargo*

Okay. And then any thoughts on the industry overall, whether you'd expect more significant dealership closures?

**Brett Roberts** – *Credit Acceptance Corporation*

No, I think it's hard to forecast that.

**Operator**

We have a follow-up question from Moshe Orenbuch from Crédit Suisse.

**Moshe Orenbuch** – *Crédit Suisse*

Maybe can you guys just talk a little bit about the competitive environment and kind of how you see it at this stage in terms of the ability to kind of originate in what you're doing?

**Brett Roberts** – *Credit Acceptance Corporation*

Sure. It was difficult, as you know, before the pandemic started. There was maybe some thought that capital might dry up for the industry; that didn't happen. So you have lots of capital. All the same competitors are out there that were before the pandemic, so I think you can expect it to return to a fairly competitive state.

**Moshe Orenbuch** – *Crédit Suisse*

Got it. And you had mentioned before that unemployment doesn't factor into the models. But does unemployment factor into your ability to kind of originate a loan? Like will you originate a loan to someone who is not employed or is employed and furloughed?

**Brett Roberts** – *Credit Acceptance Corporation*

Historically, when we go into an economic downturn, we've done very, very well from a demand perspective. Whether that will happen again, who knows. But typically, that hasn't been the concern. But this is a little bit different in that you have an economic downturn, but you have lots of capital available. So we'll just have to see how it plays out.

**Operator**

There are 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** – *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**

Once again, this concludes today's conference. We thank you for your participation.