CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
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Operator: Good day, everyone. Welcome to the Credit Acceptance Corporation Third Quarter 2015 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, Candace. Good afternoon and welcome to the Credit Acceptance Corporation Third Quarter 2015 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 on the phone lines, if you would like to ask a question at this time, please press star followed by the number one key on your touchtone telephone. If your question has been answered and you wish to remove yourself from the queue you may press the pound key.

And our first question comes from John Rowan of Janney. Your line is now open.

John Rowan: Good afternoon, guys. I'm just trying to understand what drove the provision expense, because it doesn't look like -- it looks like the only vintage where there was a negative variance versus June was 2012. But if you look at the footnotes on 2015, it doesn't look like you actually wrote down anything through June 30, and that the reduction was more just new paper. So, I'm curious as to why there was a provision if it doesn't look like you were writing down anything substantially that had already been booked?

Brett Roberts: I think the best way to approach it is that you have to understand what generates the provision for credit losses, understand how we account for the business, and understand why we provide adjusted earnings. I think if you go through any of our public filings, if you want to grab last year's annual report and just read my letter, I think we take a lot of effort and time to explain exactly how all that works. And the bottom line is, the reason we provide the adjusted earnings is because we don't believe that GAAP provides a true picture of the economics. So, in adjusted earnings there is no provision for credit losses and you don't have to worry about questions like the one you just asked.

John Rowan: I understand how the accounting works, but when you take a provision it means that you are reducing the expected forecast and collections of a certain pool, and I just want to understand where that -- you must have written something down as to how the provision works, so I'm trying to understand.

Brett Roberts: Maybe the thing you're missing is that it's done on a dealer-by-dealer basis, so if you think about it, we have thousands of dealer pools. If our overall forecast doesn't change at all, and on one dealer pool the forecast goes up by $1,000 and on another pool it does down by $1,000, the way the GAAP accounting works is we take a provision for the unfavorable $1,000, and we take the favorable $1,000 in over time as a yield adjustment. So, in a simple example you can see how the forecast didn't change at all, yet we recorded a $1,000 provision for credit losses. So, let's just apply that to the thousands of pools and what you have is a situation where pretty much every quarter we've had positive forecast variances and yet we recorded a provision. So, hopefully from that you can understand that there is not necessarily a relationship between the overall forecast change and the amount of provision that's recorded.

John Rowan: You know, I understand that, and the yield adjustments come through and looks like an increase in the effective yield on the portfolio. I get that, and obviously those provisions over time have offset some of the reduction and spread to help make the portfolio yield look, and realistically is, actually better than what you had forecasted. But, I mean, a provision means that you're writing down something, and I just -- I mean, I guess maybe I'm not going to get an answer to it, but there is obviously a reduction to something. But I guess moving on --

Brett Roberts: We wrote down dealer pools, in answer to your question.

John Rowan: No, I understand. I was just trying to understand what you wrote down. Was it 2015? Was it newer loans? I'm just trying to get some color around where something underperformed.

Brett Roberts: Nothing underperformed. You can see that on page 2 of the earnings release, if you look at the overall performance. We had an overall positive forecast change for the quarter. So, the overall business didn't underperform. If you think about thousands of dealer pools, you're going to have some that underperform, roughly half in any given period, and some that overperform, again, roughly half. So, it's the 50 percent that underperform that generated the provision.

John Rowan: OK. The ABS market. There has been some chatter of some disruptions. Obviously, the spreads on some of the lower tier loans with -- the lower tranches have widened quite a bit. What type of pricing do you think you'll get on future deals, and do you think there will be any impact on new rules that are going to require you to hold more equity against future deals?

Douglas Busk: Good point. As compared to the first part of this year, the spreads on really all tranches of ABS are wider -- AAA all the way down to BB. The spread widening is more pronounced the further down you go in the capital stack. Our last deal that we did was done in August and including issuance fees had an all-in rate of 3 percent. I think it's fair to say that if we were to issue today, just looking at the experience of other issuers, we'd probably be in the 3.3 percent, 3.4 percent, 3.5 percent range. That's how much spread widening has occurred in the market since August. Relative to the risk retention rules, we already hold a sizable first loss position in the securitizations, 20 percent OC plus a reserve account, so the risk retention rules as written aren't going to really have an impact on the structure of our deals.

John Rowan: OK. I just want to make sure that 20 percent OC was more so a function of the 80/20 split with the dealer as far as the cash flow, but that does count for the reserve account, I assume, under the new risk retention rules?

Douglas Busk: The 20 percent OC that I alluded to really relates to the dealer loan and purchase loan balance that we contribute to the deals. So, we're securitizing our investment in the loan and, as we understand it, the risk retention rules would apply to our investment in the loan.

John Rowan: OK. And then just one last question for me. There was a lot of growth from new dealer partners, right? 69 percent growth in units from new dealer partners, and since July there has been a pretty big reduction in the forecasted collections. And obviously that is made up with a reduction in the advance rate. But I'm trying to understand with the new dealers that you're going after, are you gaining pricing power going into new dealerships, because there is less competition, more competition, are you able to drive the advance rate down on new dealerships more so than legacy dealerships? And how is that changing the customer profile that you're going after with all these new dealerships?

Brett Roberts: Two separate things. So, there is a mix of business that is changing a bit, which we've talked about in prior calls. The new dealers who sign up on our program, they get the same program as everyone else so there is really no difference between a new dealer and existing dealer from that perspective. To put it in perspective, we wrote 73,000 plus loans in the quarter and just over 4,000 of those were from dealers that were new.

John Rowan: OK. Thank you very much. Have a good evening.

Operator: Thank you. And our next question comes from Moshe Orenbuch of Credit Suisse. Your line is now open.

Moshe Orenbuch: Great, thanks. Doug, I think you just kind of alluded to a little bit about the change in mix towards the purchase loans, and that continued in this quarter. It's been going on for several quarters. Could you just talk about how you see that shaking out prospectively?

Brett Roberts: As we've talked about it in prior quarters, we see it as really just a different channel for us. We like our traditional portfolio program because it creates an alignment of interest between us, the dealer, and the customer who is purchasing the vehicle. So, that's the program that we prefer. Having said that, we do see that there is a different market out there, a different channel for us, consisting of dealers that aren't interested in that traditional program, and we think there is a subset of those dealers that we can write profitable business with, so we've begun to pursue those dealers. It has increased. It's still much lower in terms of the distribution than it was in 2007, for example. Still a pretty modest percentage of the total, but we're happy with that business and we're happy with how it's performing, and we're happy with the profitability, and we hope to continue to expand it.

Moshe Orenbuch: Got it. And the comments that you made about capital return, I mean, while that accelerated level of growth is there, is that still in effect, I guess?

Douglas Busk: It's something we look at on an ongoing basis. Obviously, we've been growing more rapidly this year, haven't bought back any stock, but it's something we continue to evaluate. We have a very strong position from an availability perspective. We have $950 million available on our revolving lines of credit, over $100 million in cash. So, a very good liquidity position, that we will continue to assess on an ongoing basis.

Moshe Orenbuch: Right. And the last thing for me is one of the metrics that you've pointed out before, the volume per dealer, and you had some good growth there, I would say. Anything you can tell us about overall competitiveness of the market or how we should think about that prospect in the latter part of this year and into 2016?

Brett Roberts: Yes, it was a solid quarter from a volume-per-dealer perspective, up 10.6 percent, so very pleased with that result. In terms of the competitive environment, really, all we can say it was good enough to allow us to grow volume per dealer at 10.6 percent. How much of that is things we've done internally and how much of that is the external environment is always difficult to say.

Moshe Orenbuch: Anything you can share with us about the steps you've taken internally?

Brett Roberts: I think from a sales execution standpoint, we're pleased with our progress there. We did grow the sales force very rapidly for a period of time. We had some work to do to make that successful and we're starting to see a pay off in terms of the productivity per salesperson. I think it shows up most visibly in the new dealers that we're signing up. You know, volume per dealer can be affected by a lot of different things, but I think when we sign up a new dealer, we can attribute that to the sales team. So, I think they're doing a great job. We made some program changes. I think the changes we've made with respect to terms have been popular with the dealers. We've begun to originate all of our contracts electronically, and that's been a very popular add for our dealers. So, I think there are a lot of things that we're doing internally that we're proud of.

Moshe Orenbuch: Great. Thanks very much.

Operator: Thank you. And our next question comes from John Hecht of Jefferies. Your line is now open.

John Hecht: Thank you very much. I guess just maybe a question, stepping back, I'm interested in your opinion on what's going on, generally speaking, with consumer credit. We just got a lot of mixed economic data, you're seeing a little bit of mixed signals in terms of charge-offs from some of the indirect lenders. So, I just want to see, do you see any duress in your customer base or anything that would just give us any indication of what might be going on out there?

Brett Roberts: I think the best answer for that would be on page 2 of our earnings release where we go through each year's originations. We provide 10 years of data, which is pretty unique. I don't think anybody in the industry provides that level of disclosure. We tell you exactly what we thought when we originated the loan, how we thought it was going to perform, then we compare that to how it actually performs over time and tell you whether we were optimistic or the opposite when we wrote the loan. What you learn from that is that over the last 10 years we have an overall favorable variance with eight years that were positive and two that were negative. The two years that were unfavorable I think are remarkable because they both occurred during the financial crisis, when those loans were serviced during a period of severe economic distress. And the variances, although they were negative, were very small in terms of magnitude.

So, what we see more recently is that every pool still has a positive variance, at least the last eight years, but the magnitude of that positive variance has been decreasing. So, that may be evidence of what you're talking about. Typically, when you go through a period where there is more competition, that can show up in loan performance, so we've been expecting that sort of strong positive variance that we've seen to diminish. And so if you look at those static pools we provide, you can certainly see that trend.

John Hecht: Yes, I see that. And I guess, then, maybe a different way of asking it is, your collection expectations for this year are lower, I think, than any years except for 2007. Is that -- and I know you guys, your accounting and your credit risk exposure is totally different than that, but is that because you're buying deeper or is that because the consumer is under more duress?

Brett Roberts: It doesn't have anything to do with duress, it's really just a change in the mix of business, primarily in longer term.

John Hecht: OK, the term, OK, that answers the question. You guys spoke of that last quarter. OK, second question is, I'm just curious about this, because we track regulatory issues and we've heard over and over the CFPB and their focus on the dealer markup issue and the disparate impact. I'm just wondering, you guys buy so much differently than an indirect lender, is that issue associated with you at all, or because you buy differently that's not even a relevant issue?

Brett Roberts: I think the way we look at it is anything that is a priority for the CFPB becomes a priority for us, so we watch everything that they say, everything they do. We read everything that they publish, and we pay careful attention to it and we make sure that we're comfortable with the way we address those issues.

John Hecht: OK, but is there a specific dealer markup with each of your loans or because you're just buying at a discount that's not a directly relevant concept?

Brett Roberts: It's a different issue for us. We don't do the traditional buy rate, sell rate methodology that has been talked about by the CFPB. So, we don't give the dealer a rate so he can mark it up and we'll pay him the difference. That's not the way our program works. We typically set the rate for the dealer.

John Hecht: OK, that's what I thought. Thanks very much.

Operator: Thank you. And as a reminder, ladies and gentlemen, if you would like to ask a question at this time please press star followed by the number one key. And our next question comes from Robert Dodd of Raymond James. Your line is now open.

Robert Dodd: Hi, guys. Good afternoon. Going back to the provision issue, if I can. I understand the balance between some dealers within pools outperforming, some underperforming. If we look at this year, it was $1 million, $2 million,

$5 million, so it's accelerating. Is there anything -- it looks becoming maybe arguably something more of a bar balance in terms of groups of dealers disappointing expectations at maybe a higher rate. Is there any commonality between the groups that are getting the markdowns? Geographic, size of loan, term of loan, anything like that in terms of warnings about where you may make adjustments in terms of how you deal with these dealer groups and new dealers that match the same kind of specs?

Brett Roberts: We don't really look at it through the lens of the provision. I mean, the provision is something we do for our GAAP statements and we don't really focus on that internally, because we don't believe it's a real expense. That's not how we think about the business, but we definitely look at variances between actual performance and forecast performance. We look at it across segments, combination of segments. We look at it every way you can think of. We've always done that. If we feel like we see any trends by segment, then we make adjustments.

Robert Dodd: OK, got it. On the collectability, obviously in the first half, 68.5 percent, the initial forecast, and that has come down in the third quarter. The advance has come down as well, but not as much. So, the projected spread on the new loans has come down a little bit. Obviously, there is mix related there, but can you give us any -- is there a level at which you would be comfortable continuing to originate loans that's lower than where they are currently, or have we kind of reached an IRR floor, from your perspective on where pricing mix, so-to-speak, could go?

Brett Roberts: The return was 12.6 percent unlevered after tax return on capital for the quarter, so still a very strong number. It's well above our weighted average cost of capital, which would be the floor, at which we would stop originating business.

Robert Dodd: Right. But just to clarify, the return in the quarter is not really dominated by the originations from this quarter, so I don't know what’s the incremental return you expect at 66.5 percent and 22.8 percent spread, but it's not going to be the same as the blended average, right? So, any more color on kind of the incremental rather than the average?

Brett Roberts: I think it's the same point. The incremental returns and return on business that we expect to make on the business we wrote last quarter is still well above our hurdle rate.

Robert Dodd: OK, got it. Thank you.

Operator: Thank you. And our next question comes from Vincent Caintic of Macquarie. Your line is now open.

Vincent Caintic: Hey, thanks, guys. Just have a broader industry question. We've been hearing feedback from some other subprime auto lending companies including Santander this morning, that 2016 is shaping up to be more competitive on the one hand, and also the recovery rates are forecasted to maybe come down a bit. I was wondering what your view is on the industry landscape; how does that affect your business and what is your take on perhaps how things are going to operate in 2016? Thanks.

Brett Roberts: I don't have any insight into how competitive it's going to be next month, let alone 2016, so I really have no insight into that. We always price the business the same way to maximize the total amount of economic profit we generate. We know we'll go through periods where it's difficult, we'll go through periods when it's easy, and we're prepared to adjust to both of those periods, but we don't spend a lot of time trying to figure out which period we're going to be in next month or next year.

Douglas Busk: In terms of recovery rates, that's something you think would have a meaningful impact on the business, but if you look over time, whether the Manheim Index is at 120 or something way less than that, it just hasn't had a big impact on our financial results. So, we don't really spend a lot of time thinking or worrying about that, either.

Vincent Caintic: OK, got it. Thank you.

Operator: Thank you. And our next question comes from Lucy Webster of Compass. Your line is now open.

Lucy Webster: Hey, guys. I'm not sure if this is something that you've ever talked about before or maybe that you would provide, but I'm just wondering, do you have a sense of the sort of percentage of loans in your portfolio program that end up in repossession or being repossessed?

Douglas Busk: Yes. It's about 35 percent, approximately.

Lucy Webster: OK, great. Thanks. That's all I had.

Operator: Thank you. And our next question comes from Clifford Sosin of CAS Investment Partners. Your line is now open.

Clifford Sosin: Hi. My question has to do with the difference in unit volume percentage growth and dollar volume percentage growth. I understand from the release that it was due to a decrease in the average advance rate due to a decrease in the average initial forecast. I guess what drove the decrease in the average initial forecast of consumer loans? Was it a lower level of used car prices, a difference in the tiering of the customers, or something else?

Brett Roberts: Primarily, it's a mix issue, primarily the increasing term.

Clifford Sosin: I'm sorry, increasing the term, you said? Wouldn't a term, an increase in term increase the dollar value per unit?

Douglas Busk: It would increase the size of the loan, which we point out in the press release. So, it increased the sum of the payments due from the consumer, but that was more than offset by a reduction in the advance when expressed as a percentage of the sum of the payments due from the consumer. So, the longer-term loans, all equal, have a lower forecasting collection rate that caused us to drop our advance, which was the primary driver behind the smaller advance and lower dollar volume versus unit volume.

Clifford Sosin: OK. I'll catch up with you on this later. Thank you.

Operator: Thank you. And with no further questions in the queue, I'd like to turn the conference back over to Mr. Busk for any additional or closing remarks.

Douglas Busk: 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 with you again next quarter. Thank you.

Operator: Once again, ladies and gentlemen, this does conclude today's conference. Thank you for your participation and have a wonderful day.

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