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 Third 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 Third 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.

At this time, Brett Roberts, our Chief Executive Officer; Ken Booth, our Chief Financial Officer, and I will take your questions.

Operator
(Operator Instructions)

Your first question comes from the line of John Rowan from Janney.

John Rowan – *Janney*
Have you guys made any changes to CAPS recently regarding how the unit prices are input into the system?

Brett Roberts – *Credit Acceptance Corporation*

Not sure what you're referring to specifically.

What do you mean?

John Rowan – *Janney*
I mean are the dealers allowed to…are the prices for the cars in CAPS now linked to the advertisements that the dealers are putting out?

Brett Roberts – *Credit Acceptance Corporation*

The prices in CAPS come from the dealer. So for the most part, we get a feed from their DMS that supplies the selling price.

John Rowan – *Janney*
Okay. You haven't made any changes recently to the ability for that dealer to change the price in CAPS?

Brett Roberts – *Credit Acceptance Corporation*

I don't know what you mean the price in CAPS?

John Rowan – *Janney*

Well, the price of the car when they're submitting the loan application for the client.

Brett Roberts – *Credit Acceptance Corporation*

No. The feed comes from the DMS, the dealer supplies us with the selling price and CAPS starts with the selling price that the dealer supplies

John Rowan – *Janney*

Okay. I was a little surprised to see the reduction in dealer partner units. Can you talk a little bit about the reduction in the unit per dealer partner? Obviously, I would have thought competition would have been a little bit weaker this quarter. Maybe just go over the competitive environment and why there was a little decline in the average dealer partner productivity?

Brett Roberts – *Credit Acceptance Corporation*

I would just point you to the reasons that we gave in the release. We had wholesale prices increase and that changes the retail price that the dealer has to offer the car for. So our customer at the lower end of the credit spectrum probably gets squeezed out when there's a sharp increase in the wholesale prices. So that's only one aspect of it. You have the other things we mentioned in the release, the stimulus payments and the unemployment benefits.

Operator

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

Moshe Orenbuch – *Crédit Suisse*

Sort of maybe just keeping on the same theme.

Is that the reason that this started, I guess, before the stimulus payments, while the stimulus payments were still being received by anyone who was unemployed?

Brett Roberts – *Credit Acceptance Corporation*

When you say this started, what are you precisely referring to?

Moshe Orenbuch – *Crédit Suisse*

Well, I'm saying the decline -- I guess, the decline in volume, you kind of gave there the monthly -- the monthly volumes, and you saw the biggest declines in the last four months. It started, I guess, in July, while the stimulus payments were still being received.

Brett Roberts – *Credit Acceptance Corporation*

Yes. It's partly speculation. Obviously March and April were down. May and June responded strongly. July was a bit of a transition month. And then you got three weaker months in a row, the two last months of Q3 and then again in October. So we -- in the release, we gave you our best shot at why we think you're seeing the numbers that we're seeing. But if you have other theories that's fine as well.

Moshe Orenbuch – *Crédit Suisse*

Right. I mean, is there anything that you would think that's happening in the environment that would make that either turn around or get worse? Like, what do you see and what's gone on since then, would it require a reduction in wholesale prices? Or are there other strategies that you've got to take care of the market?

Brett Roberts – *Credit Acceptance Corporation*

Not near term. I mean the numbers in the release are through the 28th. So we don't have anything beyond that, that we know about that we didn't disclose. But the long-term strategy is to continue to make the culture better and continue to make the product better. And over a long period of time, that's been successful. So we're not going to change that strategy.

Moshe Orenbuch – *Crédit Suisse*

And anything that you could talk to that you do in the interim to mitigate that impact? Or does it just kind of roll through?

Brett Roberts – *Credit Acceptance Corporation*

Well, it depends on what happens. So we'll have to see. We've got a long history of growing dealers and growing unit volumes over a long period of time. It doesn't happen every quarter. It doesn't happen every month, but the long-term trajectory is good. So like I said, we're just going to stick with the same strategy here.

Moshe Orenbuch – *Crédit Suisse*

I guess it's likely that at some point, in the near future, you'll see some return of some amount of stimulus. Do you have thoughts as to whether that's enough to qualify the borrowers for the car at these prices? Or is it just going to have to wait until used car prices normalize some more?

Brett Roberts – *Credit Acceptance Corporation*

I think both of those things will help. If wholesale values come down, I think that will help. And if they stabilize, that will help as well.

Operator

Your next question comes from the line of Kyle Joseph from Jefferies.

Kyle Joseph – *Jefferies*

I just noticed that the Dealer Loan unit volume increased as a percentage of the total originations. What specifically drove that? And is that a trend you would expect to continue in the current environment?

Douglas Busk – *Credit Acceptance Corporation*

I mean it was up a couple of percentage points, not a material change in the grand scheme of things. I don't really have any expectations for whether that trend will continue or not in upcoming quarters.

Kyle Joseph – *Jefferies*

Got it. And obviously, credit was very strong this quarter. Given lower gross charge-offs as well as elevated residual values, and not surprisingly your forecasted collections improved. I would just ask what sort of macro assumptions are baked into those? Would there be ongoing stimulus? What's your outlook for residual values going forward?

Brett Roberts – *Credit Acceptance Corporation*

Yes. So that question or a similar question was asked at the end of the first quarter, if you go back to the transcript of that call and what we told you was that we have our mechanical forecast that looks at historical data for similar loans and then forecasts based on the historical data.

And in Q1, the forecast -- the mechanical forecast declined by roughly $40 million. We then, on top of that, given the pandemic, added another $160 million, I'm talking about net cash flows here, and reduced our overall forecast by the total; those two numbers roughly $200 million.

And then so last quarter, got the same question, what we said was that we haven't changed the subjective part of it, which is that larger number, the $160 million. So we're running the mechanical forecast, and then on top of that, we have this subjective adjustment that's meant to consider the macro environment. So again, same answer in Q3, we haven't changed anything with respect to the subjective piece and the positive forecast change you see in Q3 relates to the mechanical piece.

Douglas Busk – *Credit Acceptance Corporation*

In terms of recovery values or used car prices, those are a pretty small portion of our overall cash flow stream. So whatever you end up assuming there doesn't really move the needle all that much.

Operator
(Operator Instructions)

Your next question comes from the line of Rob Wildhack from Autonomous Research.

Rob Wildhack – *Autonomous Research*
Just wanted to get some more color on the active dealer count. What was behind the decline there? And what's your outlook from here? Do you think that could return to growth?

Brett Roberts – *Credit Acceptance Corporation*

So the active dealer count, both elements were soft this quarter. We saw higher attrition and continue the trends from the prior quarters as we're not signing up as many dealers as we did in prior years. So the active dealer count is really a function of those two variables.

Rob Wildhack – *Autonomous Research*
Okay. Is there anything that you can point to specifically behind the higher attrition rates in the quarter?

Brett Roberts – *Credit Acceptance Corporation*

It would be speculation, but it would be the same things we listed in the release; just like they affect volume overall, they affect the number of active dealers.

Rob Wildhack – *Autonomous Research*

Okay. Yes, that makes sense. And in the past, you've made changes to things like the dealer enrollment fee and sales force incentives. Can you give us an update on the progress that those changes have made? And are there any other levers you might have to spark some more growth?

Brett Roberts – *Credit Acceptance Corporation*
Yes. Hopefully, there are. Again, it gets back to the strategy that the volume, it reflects some of these macro factors, external factors.

But ultimately, it's going to be a function of how valuable we can make our product. And so that's what we're focused on doing; if we have a valuable product, then I'm sure that we'll have some growth in the future and our future success just depends on our ability to continually improve our product.

Operator
Your next question comes from the line of Vincent Caintic from Stephens.

Vincent Caintic – *Stephens*
First question on the financings that you are able to book—so understanding that counts are down and maybe competition or used car prices is pressuring you—but if, on the loans that you are booking, is there any differences than loans that you were booking previously, or pre-COVID? So thinking, for example, the quality of the customer, the quality of the car or the stipulations or anything else that might be different.

Douglas Busk – *Credit Acceptance Corporation*
Well, recent originations have continued a trend of financing a more expensive vehicle for a slightly longer term. So that's a continuation of a trend that's existed for a very long time. We've seen a little bit of change in FICO score. If you

look at our disclosure in the 10-Q, you can see that, that number has changed a little bit. So the average FICO has moved up a bit, but it's not real material overall. I think the biggest thing is just the continuation of the vehicle-term trend that I mentioned.

Vincent Caintic – *Stephens*

Okay. Got it. And I noticed you didn't buy any stock this quarter. And I'm just wondering with the stock price having dipped down a little bit, and I'm not sure if litigation or anything else kind of keeps you on the sidelines. But if the portfolio is shrinking or demand is slowing, just sort of wondering if you could use your capital in other ways such as buying back your stock or other forms of capital return?

Douglas Busk – *Credit Acceptance Corporation*

We've certainly bought back a lot of stock over a long period of time, reduced the share count from over 50 million to 17.5 million. So certainly, historically we've been opportunistic share purchasers, and I expect that that would continue in the future.

Operator

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

Moshe Orenbuch – *Crédit Suisse*

Great. I just wanted to follow up. You had mentioned that you didn't take an overlay adjustment, but that the reversal of the reserve was just looking at the actual performance. I mean how should we think about it because obviously, most of that period included times in which the borrowers were receiving that stimulus. You now have more of an extended period of time where they haven't, and how should we think about it, either if there is additional stimulus at some point in the future, or if there isn't? How should we think about that behavior?

Brett Roberts – *Credit Acceptance Corporation*

Yes. I think we'll react to what we see in the portfolio. So intuitively, if there's more stimulus, that's going to help. But it's hard to book an adjustment based on the size of the stimulus. So we'll just look at the performance of the portfolio. And like I said, the adjustment that we're making on the forecast continues, the one that we put in place in Q1.

At this point, the actual performance has been better than we would have expected when we put that adjustment in place. So if it continues, the ultimate forecast and collection rate is going to be the same no matter how we forecast it, right? When you get to the end, that's the number that you're trying to forecast now. So if things continue in a positive way, then the forecast will gradually move up over time. If they don't, that's why we have the adjustment in place.

And obviously, if they get worse, we'll have to make a larger adjustment.

Operator

Your next question comes from the line of Randy Heck from Goodnow Investments.

Randy Heck – *Goodnow Investments*

Brett, I missed the first couple of minutes of the call, so I apologize if this was asked. But have there been pricing changes this year post-COVID or once the COVID hit? Did you tighten pricing, or since that time, if you made any changes to pricing?

Brett Roberts – *Credit Acceptance Corporation*

So no change to the strategy with respect to pricing. We're trying to optimize the amount of economic profit that we generate. We typically try to stay away from specific discussions about which pricing changes we've made and when, but you can get probably a reasonable feel for that if you just look through the disclosures that are in the Q. If we make pricing changes, they show up in the disclosures related to the average loan.

Randy Heck – *Goodnow Investments*

Right. Okay. Because I was wondering if that perhaps has had an impact on unit volumes, if there were changes.

Brett Roberts – *Credit Acceptance Corporation*
I mean we typically stay away from specific discussions about pricing strategy.

Randy Heck – *Goodnow Investments*
Okay. And then a week or so ago, you announced the largest ABS deal in the company's history of $600 million, I think it was, at the lowest cost, 1.8%. Was that opportunistic? Or why that large of an ABS deal of your unit volumes have been weaker?

Douglas Busk – *Credit Acceptance Corporation*
There was an opportunistic element to it. You've got a unique situation in the ABS markets where base rates are very low. And credit spreads are pretty attractive, and the combination of the two results in, obviously, very low cost financing. So there was a little bit of an opportunistic element to it. It was the third deal we've done this year. If you look back at prior years, that's our normal cadence. So it isn't like we were doing a deal that we historically wouldn't have, what was unique is just the size.

Operator
With no further question on queue. I would like to turn the conference back to Mr. Busk for any additional or closing remarks.

Douglas Busk – *Credit Acceptance Corporation*

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 concludes today's conference call. We thank you for your participation.