CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
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Operator: Good day everyone, and welcome to the Credit Acceptance Corporation Third 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 Acceptances' 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, Candice. Good afternoon and welcome to the Credit Acceptance Corporation Third 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: Thank you. Ladies and gentlemen on the phone lines, if you would like to ask a question at this time, please press star and then the number one key 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 our first question comes from the line of John Hecht of Jefferies. Your line is now open.

John Hecht: Afternoon guys, thanks for taking my questions. This seems like old hat, but you did give an update with the CID and you talked about some dealership arbitration. Number one, is anything new with the CID that you announced and is there anything new with this dealership arbitration that you're announcing?

Douglas Busk: There really isn't anything new on either matter. We've submitted the requested information to the FTC and are basically waiting. Nothing new on the arbitration front.

John Hecht: OK. New dealership growth resumed after a little bit of disruption last quarter. I think the last couple of years, you've been focusing on hiring reps to get new dealers. I'm wondering if you could just talk about the efforts there and the willingness of new dealers to sign up new lenders at this point in time?

Brett Roberts: Probably the same story as last quarter. We grew dealers at roughly 10 percent, about the same as in Q2. The salesforce grew slightly, I think, year-over-year, but not a significant amount. We are still focused on filling in the salesforce that we have.

We ramped it up pretty quickly and we're just trying to get the existing salesforce more productive at this point. The numbers are what they are. We'd like to be enrolling dealers a bit faster than what we are, but 10 percent is what it was for the quarter.

John Hecht: Last question, can you comment on the end markets? It looks like your discount rate trends are stabilizing, maybe you're still able to show dealership and portfolio growth. I know you'd like it more.

We heard from Ally this morning that suggested that maybe pricing pressures were normalizing or coming down and then you've got a lot of regulatory pressure on the banks to maybe have them pull back? Are you seeing any of the normalization of credit trends or is it still hypercompetitive out there?

Brett Roberts: I think it's still very competitive. I think the best thing to look at for us is volume per dealer, which is at the low end of the historical range. If you want to look at revenue yield or the spreads in our table, those are also – we're pricing about as aggressively as we ever have. So the combination of those two things leads us to the conclusion that it's still very competitive out there.

John Hecht: Still competitive, but getting worse or stable competitiveness? Any kind of color there?

Brett Roberts: I would say the numbers speak for themselves. The unit volume growth is roughly the same as last quarter. We didn't change pricing on the portfolio program, which is 90 percent of the business. We did get more aggressive on the purchase program but that represents a pretty small part of the business at this point.

John Hecht: Great. Really appreciate the color, guys.

Operator: Thank you, and our next question comes from the line of David Henle of DLH Capital. Your line is now open.

David Henle: Could you just spend a second talking about what impact, if any, gasoline prices, to the extent they stay down here, will have a beneficial effect to your business, either on the credit loss side or in terms of loan demand?

Brett Roberts: Probably not a material impact either way. Gas prices is something that you intuitively might think would impact our business, but over a long period of time, when we've looked at it, we haven't found a significant impact.

David Henle: OK, thanks.

Operator: Thank you and our next question comes from the line of Robert Dodd of Raymond James. Your line is now open.

Robert Dodd: Hi guys. On the purchase program, which you said is a relatively small part of the business but it has been growing and you've been getting more aggressive on that front, when I look at the table, and these are very small changes I understand, but there's five vintages where the forecast collection was revised down by 0.1 percent, a very small number.

Obviously, so far it looks like that deteriorates a little bit in the third quarter versus the first two quarters of 2014.

So can you give us any more color on where you think the capital return is in terms of appropriateness on continuing to expand that purchase program, given that the spread has been ticking down the last few quarters?

Brett Roberts: Can you help me out the premise of your question? For which periods did you see a collection decline?

Robert Dodd: In 2014, 2013, 2011, 2009, and 2008 all forecast collections ticked down on the purchase program by 0.1 percent. Small, but they all moved down versus what was in the 10-Q for the second quarter, for example.

Brett Roberts: Again, pretty small numbers there. We're happy with the performance of the purchase business, happy with the performance of the portfolio business, at this point.

With the portfolio business, a big part of that program is the alignment of interest with the dealer. So the dealer makes money if the customer pays and the amount they make is proportionate to the success in the collection part of the process.

We like to keep the integrity of that program by making sure that if we're selling dealers a program that pays out money over time, we make sure there is money over time to pay out. So we can't over-advance on that program or really compete on price, at least that's been our philosophy. The purchase program doesn't have that same constraint and so we can price to achieve the best mix of unit volume and profit per unit, which is what we're doing there.

So we continuously run different challengers at different price points and we pick the one that we think is optimal and that's what we've done with the purchase program. So, we've executed that strategy and the results are ones that we're happy with at this point.

Robert Dodd: Perfect. One follow-up if I can, you mentioned trying to improve productivity per salesperson, but also productivity per dealer. Are there any new initiatives you're doing to try and boost that? Obviously, volume per active dealer, as you said, is at the low end of the historic range. Is there anything new on the card to try and move that number higher?

Brett Roberts: I don't think any game changers. We think that volume per dealer reflects the competitive environment, but it also reflects everything we do as a company. The quality of our product includes the origination function, the sales function, and the servicing function so the dealers benefit if we get better at servicing the loans. So, volume per dealer reflects everything we do and we're always trying to get better at everything we do. In terms of a strategy change or game changer, there's nothing that we're prepared to announce today.

Robert Dodd: Thank you.

Operator: Thank you and our next question comes from the line of John Rowan of Sidoti and Company. Your line is now open.

John Rowan: Good afternoon guys. Can you just talk to how you see the world going forward? If the CFPB or any regulatory agency decides to come in and set a flat dealer mark-up system? I know your system's a little different in the way that the mark-up is done, but I want to know, does it help or hurt you in the long run if there's some type of flat pricing system?

Brett Roberts: As you mentioned, our program works a little bit differently. We don't use the buy rate/sell rate mechanism that's very common in the industry, so the impact might be less direct on us. For the most part, regulatory changes that affect everybody probably have a neutral impact.

John Rowan: OK. Thank you very much.

Operator: Thank you and our next question comes from Amy DeBone of Compass Point. Your line is now open.

Amy DeBone: Hi, thanks for taking my question. Actually most of them have already been answered, but can you provide a breakdown of income derived from third-party products that go into the finance income line versus other income? I understand that a portion of it feeds into both?

Brett Roberts: I will try. The major components of other income would be income that we earn from one of the third-party warranty products, from the GAP product, from sales of GPS-SID units, dealer enrollment fees; those would probably be the four largest components of other income.

Premiums earned is the second relationship we have with a vehicle service contract provider. In terms of finance charges, Ken, is there any ancillary product income that goes through finance charges?

Douglas Busk: There's the commissions that we earn on vehicle service contracts and GAP products.

Brett Roberts: So, there's two components to the ancillary product income. One component goes through finance charge line and the other component, basically the underwriting gain or loss, goes through either other income or premiums earned depending on the program.

Amy DeBone: OK. Then the commissions in terms of size relative to the fees that go into other income, is it relatively equal or smaller than the profit share that goes into the other income line?

Douglas Busk: I don't have that number at my fingertips.

Amy DeBone: OK, that was great, very helpful. Thank you.

Operator: Thank you. Once again, ladies and gentlemen, if you do have a question, please press star one.

And our next question comes from the line of Vincent Caintic of Macquarie. Your line is now open.

Vincent Caintic: Thanks. I have two housekeeping questions and then a broader one. First, noticed that the salary and wages declined meaningfully quarter to quarter and I was wondering if that was seasonality or if there are some ongoing expense savings there?

Douglas Busk: No. About $1.6 million of the $2.4 million decline was just a reduction in stock compensation expense, due to a change in the expected vesting period. The other $800,000 was just a reduction in lower incentive compensation in our servicing function.

So I think it's normal quarter to quarter fluctuations. Don't think that there's any long-term savings there just because of the change this quarter.

Vincent Caintic: Got it, OK. The tender offer had a good subscription rate and was successful, so I was wondering if you could share how we should think about share repurchases going forward?

Douglas Busk: We're going to think about share repurchases the same way that we have in the past. Our primary objective is to make sure that we have the capital that we need to fund anticipated levels of loan originations.

To the extent that we're comfortable with that and we find ourselves with excess capital and we have an opportunity to buy back the stock at less than what we think the intrinsic value is, then we'll continue to return capital to shareholders. That's the way we've thought about it for years and don't see that changing going forward.

Vincent Caintic: OK, got it. The last, broader question, I wanted to get an update on your take on the sub-prime lending competitive environment. As part of that, noticed the 50 basis point slight uptick in your forecasted collection percentage for 2014? If you could describe what might be driving that or if that's just typical volatility in your forecasting? Thanks very much.

Brett Roberts: With the competitive environment, I think we'll just stick with what we said before. The unit volume or volume per dealer is probably the best number to look at in terms of where we are from a competitive perspective.

We're pricing as aggressively as we ever have and volume per dealer is at the low end of the historical range, so that leads us to the conclusion that it continues to be very competitive.

Over a long period of time, we'll go through periods where it's like it is today and we'll go through periods where it's likely going to be a lot easier than it is today and we just happen to be in one of the more difficult periods today.

Douglas Busk: Relative to the 2014 collections, we try to put our best number forward at the time that we originate the loan. You can see this for 2011 through 2013 originations, those loans, as they have seasoned have performed a little bit better than expected, which has caused our forecasted collection rate on those loans to increase over time. 2014, at this point, is following the same pattern. I think 2014 just reflects the continuing trend of the loans performing a little bit better than we expected when we originated them.

Vincent Caintic: OK, great. Thanks very much, guys.

Operator: Thank you and our next question comes from the line of David Scharf of JMP Securities. Your line is now open.

David Scharf: Thank you, just two questions, one - I think it's been maybe over two years now, I think September 2012 was the last time you put forth some price cuts to your dealers.

I know you're consistently unwilling to suggest there's any easing in the competitive environment out there, but to the extent is not getting worse, is it at least a fair assumption for us to assume that we shouldn't be looking at any fee reductions in the near term, given it's been two years during a much more competitive environment in which you hadn't had to change it?

Brett Roberts: Looking forward, I think it's difficult to assess whether those would be required or not. I mentioned we're a little bit resistant too changing price on the portfolio program for the reasons I indicated. We have a little more flexibility to compete on price with the purchase program. We'll continue to price using the same formula.

We just try to optimize unit volume times profit per unit and so the competitive environment will dictate, at least on the purchase program, where that price ends up. But predicting where it might be next quarter or the quarter after, I really don't have a guess there.

David Scharf: Got it. Thinking about dealer growth, it sounds like you're pleased with about 10 percent year-over-year. As you just look at the seasoning of the more recent hires on the salesperson side, is 10 percent a decent benchmark for us to think about you being able to sustain for the next year?

Brett Roberts: I think it's tough to say. We'd like to be growing our dealer base faster than 10 percent. There's a lot of dealers that could benefit from our program that don't have it. There's a big universe of dealers. We operate in a large market, but 10 percent was the best we could do in the third quarter and what it is going forward, we'll just have to see.

David Scharf: Got it. Thank you.

Operator: Thank you and our next question comes from the line of John Rowan of Sidoti and Company. Your line is now open.

John Rowan: Hey guys, thanks for taking the follow-up. Just one quick follow-up on the comp question, the $1.6 million that was reflected because of a change in the vesting period of stock options, is that a reversal from a prior accrual? I'm trying to get at whether or not that $1.6 million comes back into the comp line or if that's a permanent reduction in the run rate?

Douglas Busk: I don't think you can say it's a permanent reduction. We forecast the rate at which our restricted stock and restricted stock units will vest every month or every quarter. Based on your financial forecast, you come up with different results sometimes.

So it happened to be a reduction in expense this time. There have been other periods when it's been an increased expense, so I don't think you can conclude that it's a permanent reduction.

John Rowan: But was it a reversal from a prior accrual?

Douglas Busk: Yes.

John Rowan: OK, thank you.

Brett Roberts: The simplest way to think about it is the stock comp is $1.5 million to $4 million a quarter over the last couple of years and it's closer to the low end of the range this time and it fluctuates.

I think the thing to remember is the expense number in the third quarter reflects a stock comp number that's at the low end of the range. So, as you're modeling, you probably want to take an average over a few quarters and not just use the third quarter.

John Rowan: Thank you.

Operator: Thank you and our next question comes from the line of Kevin Foll of SG Capital. Your line is now open.

Kevin Foll: Hi, thanks for taking a question. You've talked just about the dealer growth. If we continue to see dealer growth stay sequentially at this level, which it has been at the last few quarters, as you look into next year, we're going to start to see that dealer growth look like it's flat on a year-over-year basis.

In that sort of environment, with flat dealer growth year-over-year and volume per dealer, looks like the competitive environment is still soft, would you guys expect to see revenue growth in that scenario next year?

Brett Roberts: In your scenario, if we don't grow dealers, I think it will be difficult to grow revenue.

Kevin Foll: Got it. On the attrition, it looks like the attrition for dealers was a little higher this quarter, sequentially. It seems like when I talk to dealers and talk to competitors, like Exeter and Westlake seem to be the primary competitors in this space, is it the upfront fee that you guys charge that the dealers – is that the primary reason why they would choose one of the competitors? The

$10,000 upfront free, is that a big stopping point in the sales cycle in your opinion?

Brett Roberts: I think there's two things there. One is attrition, which means they're joined the program and they've left. That's one variable and the other is just our success in signing up new dealers. If we look at the new actives per quarter per sales rep, that's remained pretty steady over a long period of time.

We always say we can do better, but the numbers are what they are and that's been pretty steady. There's different aspects of our program that a dealer would evaluate. I think we win our share and certainly those other companies would win their share as well.

Kevin Foll: Got you. There was an article today that came out from the OCC. They cited some concerns around just overall delinquencies in the industry are up about 12 percent year-over-year in bank charge-offs. It seems like we've seen some sort of uptick in delinquencies. I know that's more on the dealer's books. Is that also part of the reason why you think you're starting to see dealer growth slow here a little bit?

It's my understanding under your model the dealer holds 80 percent of the credit risk. In theory, if we're going through an environment with low credit delinquencies, CACC is the model that the dealer would choose and if we're going through a period of higher delinquencies, you'd think they would choose the other models out there where they don't have the back-end credit risk. Is that a fair assumption?

If we're going through a cycle of increasing delinquencies that, that sort of scenario may play out from a competitive standpoint that you maybe from a market share standpoint?

Brett Roberts: I think there will be a point where delinquencies increased meaningfully. I think a lot of the numbers you see today that are percentage changes over last year or sometimes they like to use two or three years ago, you're talking about a cyclical pattern where delinquencies went down to historical lows and they've started to come off those lows, but they're still at the low end of the historical range.

I don't think there's been any alarming changes in delinquencies. We would like to see industry delinquency rates increase, because that would probably be an indicator that we're sort of moving out of this part of the cycle. But I don't think dealers are really making their decision based on those sorts of numbers.

If you look at our loan performance statistics that are in our release, you can see they've been pretty steady over time. So I don't think dealers would be weighing sort of macro delinquency trends in deciding which program to use.

Kevin Foll: OK, got you. The last question on the funding environment, the cost of funds, it looks like some paper was written a couple weeks ago. The credit spreads widened about 40 basis points. Is that just a function of the cost of funds or do you think going forward, start to tick up sequentially? How do you think about that?

Douglas Busk: The cost of funds on the securitization that we did in September was about 30 basis points wider than the securitization we did in April of this year.

The credit spreads were the same. Virtually all the increase was due to an increase in base rates. I don't have a crystal ball relative to rates, but obviously rates are at historic lows. They have nowhere to go but up. How quickly that will occur is really anyone's guess.

Based on the current mix of our debt and the forward LIBOR curve, we don't see any material change in our effective interest rate for the remainder of the year and first part of next year. But again, that's assuming that the LIBOR curve and the mix of our debt remain relatively constant.

Kevin Foll: Got it. Thank you.

Operator: Thank you, and 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, ladies and gentlemen, this does conclude today's conference. Thank you for your participation and you may all disconnect.

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