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Q1 2023 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS

Douglas W. Busk *Credit Acceptance Corporation - Chief Treasury Officer*

CONFERENCE CALL PARTICIPANTS

John J. Rowan *Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance*
Moshe Ari Orenbuch *Crédit Suisse AG, Research Division - MD and Equity Research Analyst*
Raymond Cheesman *Anfield Group, LLC, Asset Management Arm - Analyst*
Robert Henry Wildhack *Autonomous Research US LP - US Capital Markets Specialty Financials Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation First Quarter 2023 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 W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Thank you. Good afternoon and welcome to the Credit Acceptance Corporation First Quarter 2023 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 laws.

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.

Our GAAP and adjusted results for the quarter include:

Forecasted profitability per consumer loan assignment for consumer loans assigned in 2020 through 2022 that was lower than our estimates at March 31, 2022, due to a decline in forecasted collection rates during the last three quarters of 2022 and slower net cash flow timing during the first quarter of 2023 primarily as a result of a decrease in consumer loan prepayments.

Stable forecasted collection rates during the first quarter of 2023, with forecasted net cash flows from our loan portfolio increasing by $9.4 million, or 0.1%. In comparison, our results for the first quarter of 2022 reflected elevated consumer loan performance that followed the distribution of federal stimulus payments and enhanced unemployment benefits.

Growth in consumer loan assignment volume as unit and dollar volumes grew 22.8% and 18.6%, respectively, as compared to the first quarter of 2022. The average balance of our loan portfolio on a GAAP and adjusted basis for the first quarter of 2023 increased 0.8% and 5.1%, respectively, as compared to the first quarter of 2022. The average balance of our loan portfolio on a GAAP and adjusted basis for the first quarter of 2023 increased 1.0% and 1.3%, respectively, as compared to the fourth quarter of 2022.

The initial spread on consumer loans assigned in the first quarter of 2023 was 21.0% compared to 19.4% on consumer loans assigned in the first quarter of 2022 and 20.9% on consumer loans assigned in the fourth quarter of 2022.

Growth in operating expenses of 14.4% as compared to the first quarter of 2022 primarily due to an increase in the number of team members in our engineering department as we are investing in our business to enhance our product and transform our technology systems to be more dealer- and customer-focused.

Adjusted net income decreased 35.6% for the first quarter of 2022 to $127 million.

Adjusted earnings per share decreased 29.4% from the first quarter of 2022 to $9.71.

At this time, Ken Booth, our Chief Executive Officer; Jay Martin, our Senior Vice President of Finance and Accounting; and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Moshe Orenbuch with Credit Suisse.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Doug, I was hoping you could just like kind of talk a little bit about -- you talked about stable collections but slower net cash flows. Just talk a little bit about what the two of those things -- what that mean and how they affect the financials as we go forward.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Well, the stable net cash flows, all else equal, should be...

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

I think you said slower net cash flows, right, and stable collections.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Stable forecasted collection rates, I'm sorry. The stable forecasted collection rates, all else equal, will cause the yield to be more stable than it would have been if the forecasted collection rates had gone up or down. Obviously, what happens in future periods and the yield on new originations impact that as well, but it's nice to have stable forecasted collection rates after the last three quarters of 2022, where we had modest declines in forecasted collection rates.

In terms of the slowing of the timing for the net cash flows, all else equal, that causes a decline in the yield on our portfolio. Obviously, cash flow is coming in over a longer period of time, which means less in current dollars than if they came in over a shorter period of time.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Got it. Which of those impacts caused the $44 million provision for forecast changes?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The slowdown in cash flow timing.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Got it. Okay. When you talk about the initial spread on the loans acquired in the period, how do we think about that relative to changes in interest rates? Or how should we think about it?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

What we're trying to do when we price our loans is maximize the amount of economic profit, which is economic profit per loan times the number of loans originated. Economic profit considers the relationship between what we paid for the loan and what we expect to collect, how those loans perform over time, and the anticipated expenses over the life of the loan, including interest expense.

If interest expense goes up, and we want to earn the same return, we need to lower advance rates assuming nothing else changes. So it's a long-winded answer to your question. It's an expense that needs to be factored into our pricing just like any other expense.

Operator

Our next question comes from Robert Wildhack with Autonomous Research.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

I wanted to ask a question about unit originations. I think you'd said back in January, or mid-February maybe, that they were up 39% in Jan '23. I think they finished up in the high 20s this quarter, which implies a decent slowdown in February and March. How much did unit origination growth slow in February and March, and what do you think is behind that slowdown?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The growth rates by month in the quarter were 39% in January, 27% in February, and 12% in March. I think a fair amount of the variability in growth rates during the quarter was primarily due to differences in the strength of prior year comparables (corrected by company after the call). We had a bit of a soft January in 2022. February and March were certainly better, so I think that prior year comps had a fair amount to do with it.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Okay. Industry-wide, I think things looked maybe the most stretched in '21 and then maybe into early '22. Coming up on 18 months from that point, and we see a lot of the headlines around delinquencies and losses in subprime auto broadly; to what degree do you think that your competitors and the industry have rationalized their underwriting?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The industry is very fragmented so I don't have tremendous insight into how each industry participant is reacting to a more challenging credit environment. I can look at the industry statistics as published by AutoCount and see that more people appear to be tapping on the brakes than are pushing on the gas. So that would lead me to believe that most, at least of the top 20 industry participants, are getting incrementally more conservative.

Operator

Our next question comes from John Rowan with Janney.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Doug, you just gave a bunch of numbers regarding the month by month-I think it was unit volume, correct? Was there any change in underwriting? Obviously, you mentioned the year-over-year comps, and that's fine, but you did have a relatively big decrease in the advance rate here for the quarter. I'm wondering if there was any coincidence with a change in the advance rate and also the slower number for March.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

We had a better number in April. If you adjust for the number of days, it was 18.0%. April was better than March. As you rightly point out, the advance rate was lower in Q4, and it was lower in Q1. In general, the less you pay the dealers at origination, the fewer loans you originate, so that likely had some impact on volume.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. -Your initial advance rate for the year is 21.0%. It looks like it's the highest number since 2016. Maybe it's in the press release, haven't gone through it yet, but is there an initial advance rate for April?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

No, that is not in the release.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. Lastly, any updates on the CFPB and New York AG issue?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

No. The latest and greatest is in the 10-Q that we filed today.

John J. Rowan ***Janney Montgomery Scott LLC, Research Division - Director of Specialty Finance***

Okay. From what was in there, it's just a motion to dismiss the whole case, correct?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Correct.

Operator

(Operator Instructions) Our next question comes from Ray Cheesman with Anfield Capital Management.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

Doug, this is such a unique environment. It has been many, many years since we had rising rates, rising inflation, credit standards tightening, lowered SNAP payments, lower tax refunds, and school debt payments restarting. How do you program that into a computer to protect you guys against people taking advantage? You've got capital. It's very attractively priced. Congratulations on the warehouse extension the other day. You're a grower, and so while maybe Citizens and Capital One let theirs run off, you guys are in the trenches. You're in there fighting. How do you take all that in and pick the good loans with the good payers on the good collateral versus everything else out there that clearly is piling up in some of the ABS numbers?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Well, we have a pretty good track record at being able to satisfactorily predict collection rates over a large number of loans. We don't have the ability to predict individual outcomes, such as differentiating which consumer is going to lose their job in 18 months or which one's going to encounter medical bills or what have you, but we. have shown the ability to be predictive over a large number of loans.

Having said that, there are several (corrected by the company after the call) factors that are not certain at the time you're underwriting a loan aside from the things I just mentioned like inflation, changes in unemployment rates, and changes in car prices. No one can accurately predict how those variables are going to behave over the terms of a 60-month auto loan. The primary way we deal with that uncertainty is to build a significant margin of safety into our loans at the time that we originate them, with the result being that even if loan performance is less than anticipated, it's still highly likely our loans are going to produce satisfactory levels of profitability.

In addition, on the portfolio program, we're sharing the risk on the loan with the dealer. If we collect $100 less on a loan, 80% of that is going to be borne by the dealer in the form of a reduction in dealer holdback. Obviously, that only works to a certain extent, but certainly, we have a layer of protection there that is helpful.

Raymond Cheesman ***Anfield Group, LLC, Asset Management Arm - Analyst***

My other question was, how does all of that environmental stuff impact you? As I said, you guys just extended your warehouse, and that was wonderful to see, but how do you think it impacts the funding environment generally? I mean we just had another bank fall apart this morning and disappear. Are you seeing your funding environment change? Is it competitors' environments changing?

Traditionally, during less terrific times for people's credit availability, you tend to do better. Is that the outlook that you still have going forward?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I think that remains to be seen. I think the fact that we've shown some better growth numbers in recent periods indicates that the market has gotten a bit better for us. I do think that the debt markets have reacted to some of the concerns around credit quality. Some banks are tightening credit. Credit spreads are wider across the board. So I think that the capital markets have reacted to it. It hasn't impacted us yet, and hopefully, it doesn't, but I think the credit markets are certainly tighter and more expensive now than they were, say, a year or 18 months ago.

Operator

Our next question is a follow-up from Moshe Orenbuch with Credit Suisse.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Doug, just two quick things. The first is you mentioned that GAAP and adjusted assets were growing in the 1% to mid-1s percent. Given what you're seeing in terms of originations and the pace of originations, that deceleration you talked about that went into April, and cash flows, if you put the two of them together, do you think that number is accelerating or decelerating into Q2 growth in loans?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Based on April numbers, we should still be growing the portfolio, but that could turn around in May or June. I think the growth in the portfolio primarily is just a function of what sort of growth we put out from this point forward.

Moshe Ari Orenbuch ***Crédit Suisse AG, Research Division - MD and Equity Research Analyst***

Got you, and then just a quick modeling one. Salaries and wages, I think, were high. I didn't get a chance to look in the Q. Was there anything in there that we should think of as one-time? Or is that the run rate?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Well, if you're comparing Q1 to Q4, there are certain expenses like payroll taxes and fringe benefits that tend to be higher in Q1, and most of the increase versus Q4 was due to seasonal impacts. Increase in sales commissions would be another one. If you're comparing it to Q1 of last year, obviously there are comparable seasonal factors , but the thing that accounts for the difference in operating expenses in Q1 this year versus Q1 last year is an increase in engineering expense that is likely to continue. So really, it depends on what your starting point is, Moshe.

Operator

Our next question is a follow-up from Robert Wildhack with Autonomous Research.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

I just wanted to ask about the repurchase. I think in the past, you've talked about when you're growing originations, you won't repurchase as much and vice versa. So just curious what the appetite for share repurchases is given the growth is a little bit slower now than it was towards the end of last year.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I think we continue to think about it the same way we always have. The first priority is to make sure we have the capital we need to fund anticipated levels of loan originations, and that obviously includes a number of subjective considerations like what the capital markets are like, what sort of bank tightening is going on, regulatory matters, et cetera. If we're comfortable with what we have, all the capital we need to fund anticipated the levels of originations, then we go to the next step. If we can buy the stock for less than we think it's worth, we do so. We're thinking about it the same way we have for many, many years.

Operator

Thank you. 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 W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

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're looking forward to talking to you again next quarter. Thank you.