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 Fourth 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 Acceptance's website. At this time I would like to turn the call over to the Credit Acceptance Senior Vice President and Treasurer, Doug Busk.

Douglas Busk: Thank you, Amanda. Good afternoon and welcome to the Credit Acceptance Corporation Fourth Quarter 2014 Earnings Call. If 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 if you have a question at this time please press star then one on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key.

Our first question comes from Vincent Caintic from Macquarie.

Vincent Caintic: Thanks guys and good evening. I wanted to touch on the comment in the press release about higher volumes due to lower competition. I just want to get a sense of what has changed, what you're seeing in the industry, and if this is something that's just for this quarter or something that you think might be evolving over the next year. Thanks.

Brett Roberts: We concluded that the competitive environment was more favorable in the quarter, mostly based on the volume per dealer which, as you know, had been running a negative year-over-year trend and turned positive this quarter. So really the best insight we have on the market is the volume per dealer number and that was up roughly 5 percent for the quarter. Nice growth in active dealers of 14.5 percent got us to the 19 percent number for the quarter.

Vincent Caintic: Got it. OK. Could you, maybe another way, what have you been seeing for this quarter in terms of those numbers? I'm just trying to get a sense if this is a continuing trend.

Brett Roberts I think it's hard to say if it's a continuing trend. I mean it is a nice data point. It was a good quarter from a volume perspective but I think it's too early to conclude whether it’s just an aberration or whether it's something that will continue in the future. Obviously January is not done yet. We typically don't talk about the month subsequent to the quarter until it's completed but if you want to send in an investor question, we'll talk about January after the month's done with.

Vincent Caintic: Got it, OK. And just a quick one on the refinancings. I just want to get a sense, you had a nice refinancing this past quarter and just wanted to get a sense of what the environment looks like for asset-backed and also your senior notes. Thanks.

Douglas Busk: When you say refinancing, are you referring to the securitization that we sent a press release out on today?

Vincent Caintic: Yes.

Douglas Busk: I would say that the ABS market continues to be receptive. Relative to middle of last year the deals are taking a little bit longer to come together and you're seeing lower subscription levels in general. But I would say the market continues to be receptive though probably a bit more challenging than we saw earlier in 2014.

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

Operator: Our next question comes from John Rowan with Sidoti & Company

John Rowan: Good afternoon, guys. The $2.2 million that you noted as a gain from changing your forecasting methodology, was that why the provision expense showed a credit?

Brett Roberts: Correct.

John Rowan: OK. And maybe you can give us some color as to what you changed. It didn't seem like you changed, it was more a function of timing. Did you push out the timing or pull forward the timing on forecasted collections?

Brett Roberts: We forecast both the amount and the timing of collections as well as dealer holdback payments and then we compare, we evaluate, the actual results against those forecasts every month. When we start to see a variance, we go through a process where we redevelop the forecasting model to get rid of that variance. It's routine maintenance, if you will, to the forecasting methodology that occurs from time-to-time.

John Rowan: How often would you say that you do this type of maintenance to the model?

Brett Roberts: We look at it every month and if the variances start to become a trend or get large enough, then we redo the models.

John Rowan: Which vintages in particular were you seeing better results versus your forecasts?

Brett Roberts: Again, it was the timing more than the amount. It wasn't the amount at all. It was just strictly a function of the timing. I think what that probably reflects is when the environment gets more competitive, we typically have greater frequency of prepayments because our customers are getting refinanced by others and so that accelerates the cash flows on the collections as well as on the holdback payments so when we see that for a period of time, then we reevaluate the model. I expect that if we enter a period when it's less competitive, we'll see a change in the opposite direction.

John Rowan: Why did you increase the term in the fourth quarter?

Brett Roberts: The term in the fourth quarter, it's just a function of our policy. So we got more generous on the term policy. That's something that really continues a trend that started when I joined the Company back in 1991.We did a 24-month term that was the max term that we would do and we've gradually inched that up over the past 25 years so now we will do a longer term and in the fourth quarter we rolled out a policy which we had experimented with which resulted in longer terms.

John Rowan: Longer terms in this space have been over the last couple years typified by greater competition. So I'm curious how that fits with your comments about competition easing a little bit and why you would go ahead and increase the term which presumably increases your risk?

Brett Roberts: I think we have started the term increase in August. So obviously we didn't have the benefit of seeing the fourth quarter results at that time. I think you're right. We probably wouldn't lengthen the term if we were growing 20 or 30 percent and competition was light. It's something that you do when the environment is more difficult and so we did it. It's calculated. It's something that we've done many times before and we're comfortable we can price it.

John Rowan: Would you be able to give us an update as to where the advance rates and forecasted collections are currently trending for whatever has been written thus far in 2015?

Brett Roberts: We don't have any data on 2015 at this point.

John Rowan: OK. And then lastly, any updates on any of the regulatory issues, the Department of Justice or the AG of Massachusetts, any updates?

Brett Roberts: No updates on any of those. We responded to the requests that we got and we haven't heard anything in addition.

John Rowan: OK. Thank you very much.

Operator: Our next question comes from John Hecht with Jefferies. Your line is open.

John Hecht: Thanks very much, gentlemen. One question just related to kind of modeling, if you will. You had an uptick in salaries and wages in the fourth quarter relative to kind of the run rate in the first part of the year. Is that just a seasonal change, or is that a new run rate going forward due to hires?

Douglas Busk: Well, you had about a $6 million increase versus Q3, and about $3.8 million of that was an increase in stock compensation expense which is just a change in vesting assumptions. As we talked about last quarter, that number tends to be relatively volatile. It can be anywhere from a $1.5 million - $2 million up to $5 million or so on a quarterly basis. So you know over half of the variance versus prior quarters is probably due to changes in levels of stock compensation.

There's another $1.5 million versus the third quarter that was a result of increased bonus expense due to improvement in various performance measures. And then you had roughly another $1 million increase in salaries and wages. Some in the support functions, some in origination and servicing. So really the last category would be the one that would tend to be more sticky. The stock comp is going to vary from quarter-to-quarter, as well as the bonus expense.

John Hecht: That's great color, thanks. The second question is more just interested in your commentary. You increased the 2013 vintage collections forecast in the quarter and then you had a small decrease in 2011/2012 and then an increase in all the other vintages.

Is that sort of just, it's the opposite of what we're seeing in terms of cumulative loss assumptions and ABS markets for indirect lenders, where you're seeing probably outperformance of 2011 and 2012 and underperformance in 2013 in terms of credit. Is this just where you're coming from or is there a different mix of assets relative to you in the market or how should one just think about those changes relative to what we're seeing elsewhere?

Brett Roberts: I think the first number I'd focus on in that table is the variance on the initial forecast. Over the last ten years we've had variances in every year, 7 of those were positive variances and three of those went the other way. The three that went the other way were primarily as a result of the financial crisis and given the severity of that crisis, the magnitude of those variances was very low. The biggest miss was in 2009 and we're happy that it was a positive miss and in the last three or four years the numbers have been relatively modest.

If you want to look for a trend there, we're running modest positive variances in all of the recent vintages. The only surprising thing there is that when the competitive environment gets more difficult, typically that puts pressure on loan performance. We really haven't seen that in recent vintages so it's a little bit of a positive surprise there. But other than that, I don't think there's anything remarkable about loan performance during the quarter.

Douglas Busk: If you look at the change in the variance from the third quarter, realize that it wasn't anything for 2009, 2010, 2011, and 2012. 2013 got a little bit better. Our expectations remained pretty consistent during the fourth quarter.

John Hecht: OK.

Brett Roberts: The other thing I might point out there, when you look at that table, you need to have a scale in mind. What constitutes a big number, what constitutes a small number. We estimate that a 100 basis point variance in the collection rate impacts our after-tax return by about 40 basis points. If you're looking at a 10 basis point change or a 20 basis point change, it's really not a significant change.

John Hecht: OK. Thanks. And then the last question, I wonder if you could just talk about your desire to do more buybacks or tenders this year? Is there any commentary around that?

Douglas Busk: You know we continue to think of buybacks the same way we have in the past. Our preference is to invest all our available capital in the business. Historically, periodically, we found ourselves in an excess capital position.

And when we find ourselves in that position, if we can buy the stock back at less than intrinsic value, we do so. Obviously there's an inverse correlation between your growth rate and the amount of stock that you can buy back. So if we grow more rapidly as we did in Q4, all things equal, we are going to buy back less stock and vice versa. But we continue to approach it the same way.

John Hecht: OK. Great. Appreciate that, guys, thanks.

Operator: Our next question comes from Robert Dodd with Raymond James. Your line is open.

Robert Dodd: Just going back to kind of the forecast collections versus advance rate. If I look at the delta and obviously you talked before about how you haven't generally changed pricing, in the term. When I look at the advance rate for 2014 versus where it was at the end of the third quarter, it's compressed 40 basis points. Obviously that's beneficial. The forecast collection has compressed 30 so net, you're ahead.

But could you give us any color on, with an improving competitive environment that you talked about, what's driving that forecast collection via 2014 dealer loans? 30 basis points isn't much but it's a change. Is there anything particularly thematic there?

Brett Roberts: We tried to address that in the release. What we said was that the lower collection rate on Q4 originations was the result of a change in mix and the lengthening term.

Robert Dodd: Right. And on that term question, when I look at the average price of the vehicle, it looks like that's up when I add everything up, about 5 percent year-over-year and it looks like an all-time high. Is that simply correlated to extending the term resulting in consumers and potential customers being able to buy a slightly more pricey vehicle with the same payment? Or is that a mix of dealer issue?

Brett Roberts: No, it's the former.

Robert Dodd: OK, got it. I appreciate it. Thanks a lot, guys.

Operator: Our next question comes from Sanjay Sen with BloombergSen. Your line is open.

Sanjay Sen: Congratulations on a great year. I just want to ask you, you made the comment about competition, the competitive environment improving. We always expected that at a certain point that would happen. I just want to just get a little more color from you just in terms of what you are seeing? Are you seeing, is it the regulatory environment which is causing capital to pull back? Is it people's worsening loan performance? I know we've seen delinquencies go up. What do you think has been driving this reduction in competition you see?

Brett Roberts: I think what we're saying is that the volume per dealer went up for the quarter, which is a change in the trend line. Absent any other explanation, we attribute that to a change in the competitive environment. But if you think about the magnitude of the change, you're talking about, you know, a half loan per dealer for the quarter.

Sanjay Sen: Right.

Brett Roberts: You don't have a lot of visibility into that. The average sales rep out in the field can't really detect that. Even the dealer can't really tell that he's giving you a half loan more over a three-month period. So you don't get a lot of anecdotal evidence to support your thesis that it got easier. It's really just a function of looking at the result and saying that's likely the competitive environment got more favorable during the quarter.

Sanjay Sen: Yes, OK. Alright, thank you very much.

Operator: Again, ladies and gentlemen, if you have a question at this time please press star then the one on your touchtone telephone.

Our next question comes from Lucy Webster, with Compass Point. Your line is open.

Lucy Webster: Hi. Thanks for taking my questions. It looks like purchased loans increased over 80 percent on a year-over-year basis. What's driving that growth? Is it pricing reductions or is there a change in programs?

Brett Roberts: I think it's really two things. One, as we said last quarter, we have gotten more aggressive on the pricing on the purchase loan product. I think that's one component of it. And I think we're increasingly doing that as just a different channel. We realize that there are dealers that aren't attracted to our traditional program, our portfolio program and so we are using the purchase program as a way to enter those dealers.

Douglas Busk: The purchase program was about 9.5 percent of originations in the third quarter. It was about 11 percent of originations in the fourth quarter. So it's continued the trend that we saw over 2014 of inching up as a percentage of the business.

Lucy Webster: Do you expect that to stabilize?

Brett Roberts: I think it's hard to say. That number's been as low as 3 or 4 percent. I think it's been as high as 30 percent. So I think it's difficult to say.

Lucy Webster: OK. And then the $2.2 million benefit from the change in the forecasting methodology. That was a non-cash benefit, right?

Brett Roberts: It's timing of cash flows, there's an economic benefit to receiving cash flows quicker but in terms of the overall amount of cash flows, our forecast hasn't changed.

Lucy Webster: OK. And then can you provide any insight on the dealer growth outlook for 2015? I know that you mentioned on the last call that it was going to be around 10 percent for 2014 so just looking forward, is it going to continue on the current trend, or is it kind of stabilized given that the volume per dealer decline has now stabilized?

Brett Roberts: We don't have a forecast for that number for next year. I mean, we have a great product and we think there's a lot of dealers that will benefit from our product that don't have it currently so we are looking to grow the dealer base over time but how quickly we do that I think is tough to predict.

Lucy Webster: OK. Thanks for taking the questions.

Operator: Our next question comes from John Rowan with Sidoti & Company. Your line is open

John Rowan: Sorry, I just had a quick follow-up. Thinking back to your accounting treatment, the $2.2 million credit that went through the provision expense, if I'm not mistaken, that had been to a prior vintage that you impaired and now reversed and are moving back up to the original assumption. Am I correct in that asymmetrical nature and the way that accounting works that that must have been by definition a previously impaired loan?

Brett Roberts: I think that's right. I try to avoid thinking about the provision and GAAP accounting treatment as much as I can but if you force me to, I think what you're saying is correct.

John Rowan: OK. Thank you.

Operator: Thank you, our next question comes from Daniel Smith with Peton Capital. Your line is open.

Daniel Smith: From an accounting standpoint, I thought previously that positive changes in forecasted collections were amortized and then this one I know it's a little different because it's a changing methodology, so why is this different and you recognize it all at once versus amortizing over the remaining life?

Brett Roberts: I think the prior question answered that one.

Douglas Busk: You can reverse a provision but if you're going to be in a situation where your yield is now expected to be greater than it was at origination, then you would take that amount into your financial results prospectively.

Daniel Smith: Per the previous question, you said it was a previously impaired loan that became unimpaired and you agreed with that.

Brett Roberts: That is correct, yes.

Daniel Smith: When you unimpair a loan, do you recognize it all at once?

Douglas Busk: Correct. You can reverse impairment in the current period, but if you end up adjusting your yield on the dealer loan to an amount greater than what you expect at origination, that would be recognized prospectively.

Daniel Smith: Can you help me understand the difference, the yield is a function of the dollars you expect to collect versus what you paid for the pool. But how is an impairment different versus forecasted collection dollars?

Douglas Busk: Well, impairment can occur due to a negative variance in collections versus expected or different timing than is expected. So you can have impairment occur as a result of either of those two things.

Daniel Smith: OK. So this $2.2 million in a previous quarter would have been a negative variance that you recognized all at once?

Douglas Busk: It could have been all at once or it could have accumulated over multiple months or quarters. But, yes, it would have been an asset that the yield was expected to be less than it was at origination. As a result, we recorded a provision and established an allowance.

Daniel Smith: OK. So it really is no different. I think that makes sense. Thank you.

Operator: 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: Ladies and gentlemen, thank you for participating in today's conference. This does conclude today's program. You may all disconnect. Everyone have a great day.

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