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 First 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, Vince. Good afternoon and welcome to Credit Acceptance Corporation First 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 Statements 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, at this time if you do have a question please press star and the number one on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue you may do so by pressing the pound key. Once again if you have a question press star and the number one.

Our first question comes from John Hecht of Jefferies, your line is open.

John Hecht: Good afternoon and thank you for taking my questions. The first question, just because I want to hear the update, is your generic discussion on competition and what's going on out there.

Brett Roberts: Really a continuation of the trend we saw last quarter. Obviously, unit volume growth was solid at 28 percent. Volume per dealer was up again for the second consecutive quarter after many quarters of decline, so that was nice to see. Active dealers grew at 18 percent, which generated a nice result for the quarter.

In terms of the competitive environment, we will probably echo the same thing we said last time. I think the best measure of that is the volume per dealer. And the fact that it grew for the second consecutive quarter and actually grew a little bit faster than it did last quarter is certainly a good sign. It's very likely an indicator that the competitive environment is a bit easier than it was a year ago.

We don't have a lot of anecdotal evidence to back that up, if you look at the numbers, the volume per dealer is up about half a contract a month. So it's not the kind of thing that a dealer or salesperson would really notice. But in the aggregate numbers it certainly generates a positive result.

John Hecht: OK. Is it as simple as some of the indirect lenders are pulling back and you are recapturing market share, or is it more complicated or dynamic than that?

Brett Roberts: It's still a very competitive marketplace. There are still lots of lenders out there that are writing loans in our part of the market. So nothing dramatic has happened. But again, in the absence of another explanation we look at the volume per dealer number as a good indicator of where the competitive environment sits.

John Hecht: OK. So marginal changes like a half contract a month just kind of adds up is what I'm hearing.

Brett Roberts: Correct.

John Hecht: OK. Looking at it, and it looks like your advance rate went down, which is obviously a good thing. But then your expected collections went down. Is that related to the duration of loans you're buying or some other commentary around that?

Brett Roberts: It's primarily the duration but also the mix of business. So the forecasted collection percentage, the absolute amount doesn't matter so much as just whether or not we hit that forecast is the important thing that will drive our returns. 68.7 percent is what we are forecasting for the business we've written so far in 2015. If we hit 68.7 percent, then that will be a good number.

John Hecht: Yes, OK. So it's mix and duration. And then, last question before I get back in the queue is: volumes were strong across the board this quarter but your purchase volume has almost doubled year over year.

And I'm wondering, is that a shift in strategic focus or is that just the volume you are getting from your dealers, number one? And number two, to the extent it is a strategic shift, how will this impact your P&L, I guess predominantly in the provision line going forward?

Brett Roberts: We have seen the level of purchase business vary dramatically over the years. Typically, when the market gets more competitive we write a little bit more purchase business. And then when the market gets less competitive we end up writing the more traditional business. It has been increasing. It's still a fairly modest percentage of the total, particularly relative to where it's been historically.

We really view it as a different channel for us. We've come to the realization that there are some dealers out there who just don't have an interest in writing our portfolio business, for one reason or another. And we don't want to exclude those dealers from our market, so we have begun to pursue those dealers that aren't interested in the traditional business, and we are happy to write purchase business with those dealers.

John Hecht: Got it, thanks very much.

Operator: Our next question comes from David Scharf of JMP Securities, your line is open.

David Scharf: Good afternoon and thanks for taking my question. Actually, maybe to reiterate on the competitive front some of the questions just asked. You guys have been doing this for decades. Trying to still get a sense – this is 30 percent or so, unusually large year-over-year increase in volumes as well as a double-digit percentage increase in average volume per dealer.

Did you get a sense that it's primarily certain key indirect lenders who are pulling back from the market that have been opening up some opportunity? Or is this more perhaps just the maturation of all the salespeople you've added in the last few years? Trying to get a sense if this is more competitive or more internally driven.

Brett Roberts: I think it's difficult to say. If you look at the list of lenders in AutoCount and how much volume people are doing, certainly there are some lenders that have pulled back, but there's many others that seem to have done the opposite.

So it's tough to get a read on it from that perspective. I'd like to think our salesforce is maturing and getting more productive. Certainly the number of dealers that we enrolled, the new actives during the quarter was a sign of that. We can't enroll a new active without a salesperson out in the field having some success. So it was nice to see that number.

And the other thing it's nice to see is we are not losing as many dealers. And that's not necessarily obvious from the release. But if you look at the sequential increase in our active dealers and you compare that with historical quarters you would see it was a very strong quarter from a dealer retention standpoint. We were happy to see that as well. But difficult to separate how much we can take credit for and how much of it is just the market.

David Scharf: Yes, and maybe shifting to – just curious, some kind of anecdotal feedback from dealers. For a new dealer to sign up on your program it takes more of a commitment on a number of levels than for a traditional indirect program. As your sales people are signing up so many more active dealers, are you hearing any anecdotal evidence from some of the newer dealers that the deepest of subprime borrower is getting more challenging to find financing for?

Brett Roberts: Not necessarily hearing it from the dealers. I think we hear a lot of positive feedback about our program from the dealers that we are signing up. They are signing up for a reason, because they feel like we can help them. So I think, again, the fact that we signed up so many dealers this quarter is a positive sign there.

And again, the dealer doesn't – it's a half contract a month, so the dealer doesn't necessarily see it as a major shift from where we were a year ago. I guess this quarter it would be a positive shift. But certainly they realize it's more competitive than it was three or four years ago. But in terms of year over year or quarter to quarter, I just don't think they have precise enough information to give us any insight there.

David Scharf: Got it. On the newer originations this quarter it looks like really the only potentially negative or just non-positive metrics seem to be the lengthening in average term versus a year ago. Any color you can provide on that? It looks like it went out to over 49 months. And maybe some context how that relates historically. Perhaps this is just a return to normalization for you.

Brett Roberts: No, I think it's a continuation of a trend that started many, many years ago. As I said last quarter, when I started with the Company the longest term we would write was 24 months. And I think that we would probably prefer that if we could get away with that in the marketplace. But the marketplace has changed. The customer expects to get a newer, nicer vehicle and in order to accommodate that you have to be willing to write a longer term.

So over the course of many, many years we have gradually lengthened that term out. And the way we've done it has been very methodical. We went from 24 to 30 months and then we made sure we could price that. We felt comfortable we could forecast the collection rates and we knew how that business would perform. Then we moved out to 36 months.

So we have just continued that trend. In the latter part of last year we extended the term out again. I think again, all things being equal, if we could get away with writing a shorter term in the marketplace, we would. But ultimately, the way we make those decisions is what is going to provide the best combination of volume and profit per unit. And we are comfortable that we have made the decision on that basis.

David Scharf: Got it. Very helpful. I'll get back in line.

Operator: Thank you. Ladies and gentlemen, again if you do have a question at this time please press star and then one on your touchtone telephone.

Our next question comes from Vincent Caintic of Macquarie, your line is open.

Vincent Caintic: Good afternoon guys, thanks very much and good quarter. It seems like, as the prior folks have alluded to, there's significant growth that has been a turnaround over the past two quarters. And yields are actually also excellent, too, which I think is a turnaround this quarter. And I just want to take a couple steps back and not necessarily focus on competition.

But what is your view of what has changed, say, this quarter and the past quarter versus, say, a year ago, where dealer counts are growing, yields are also improving? And how do you see this upcoming year playing out in terms of those same trends?

Douglas Busk: I guess first of all, relative to the yield – I think the yield has actually continued to decline, as it has gradually for several years now. So maybe you are calculating the yield differently than we are. But we have the yield calculation in our 10-Q and it has continued to tick down. It was 25.9 percent for the quarter, 27 percent for the first quarter last year, and 26.3 percent for the fourth quarter last year. So it has continued to tick down a touch.

Brett Roberts: In terms of the driver, what has changed since a year or two ago? I think it's a combination of the competitive environment and the work we do every day to try to get better at what we do. It's difficult to say how much we can take credit for and how much of it's just the external environment changing. Certainly the volume per dealer – you could probably attribute that most likely to a change in the competitive environment.

The success we've had in enrolling dealers and keeping dealers – perhaps you would weight that more as things we have done to effect positive change internally. But again, that's speculation. I think it's impossible to figure out how much of it is external and how much of it is internal.

We continue to try to get better at what we do and we've had, certainly – we grew our salesforce very quickly and then we had a period where we had to fill in and we had to go through a period of attrition and replacement and training. And I feel like our salesforce is performing at a high level today. But hopefully there's continued room for improvement there.

Vincent Caintic: Got it. That's good color. And then changing gears here, capital management – the stock has done very well and you have continued to buy back stock. Just wondering how we should think about, say, the pace of that going forward and how you think about capital management with your stock at these levels. And actually, on a side note I just noticed that the cash on your balance sheet is elevated relative to what it usually is historically and just if there's any driver to that, it would be great.

Douglas Busk: Our first priority in managing our capital is always to make sure we have the capital that we need to fund anticipated levels of originations. So what that means is, all things equal, the higher the growth rate, the less amount of stock we are going to buy back and vice versa.

So we bought back a lot of stock last year. We increased our funded debt to equity from 1.8 at the end of 2013 to about 2.5 at the end of 2014. It continues to be in the 2.5 range since year-end. So, given current origination levels we are focusing intently on making sure we have the capital that we need to fund the business at this point.

In terms of the cash sitting on the balance sheet, that's really just going to be timing, for the most part. It's really a function of the fact that we issued a $300 million securitization and a $250 million senior notes offering in the first quarter. The sum of those two things was more than the outstandings we have on our revolving credit facilities, so we are in a temporary situation where we have cash on the balance sheet.

Vincent Caintic: Got it. Thanks very much, guys. Appreciate it.

Operator: Our next question comes from David Henle of DLH Capital, your line is open.

David Henle: Could you just spend a second and remind us what the size of the salesforce is and what your plans are over the next 12 to 18 months to either grow that salesforce or not grow it? And then maybe just spend a second talking about the evolution of that salesforce, retention or turnover within the salesforce itself, and whatever challenges or difficulties that presents?

Douglas Busk: Yes. We had about 265 people in the sales area, 235 of which were salespeople, what we call Market Area Managers. Those levels haven't changed significantly over the last couple years. As Brett mentioned, we increased the salesforce pretty dramatically back in 2011 and 2012, not planning for any significant expansion of that sort in the near term. We will perhaps opportunistically increase it a little bit but nothing of the magnitude that we saw several years ago.

In terms of turnover, it's something we are focused on, something that we attempt to, obviously, minimize. So we are continuing to make sure we have the right compensation plans in place, provide the salespeople with the right tools to make them more effective. So, I'd say at this point it's just one of those things you are focused on in trying to build a healthy organization.

David Henle: And I am just curious. Once a salesperson brings in a dealer, does he or she in any way stay involved in that relationship, or do they simply turn it over to more of a relationship manager that then manages that relationship with that dealer?

Brett Roberts: No, the Market Area Manager stays with that dealer. They manage the territory and they're responsible for both enrolling new dealers and servicing active dealers.

David Henle: OK. So when you talk about your retention getting better, does some of that relate to you doing a better job with your salesforce in terms of them staying connected to dealers? Is there a connection there?

Brett Roberts: I think first of all I would say that as we roughly doubled the salesforce we did it in a very rapid period of time. That created a turnover problem. We didn't necessarily anticipate that was going to happen. Perhaps we could have. So we spent the last six to eight quarters trying to fill in where we've had attrition and also trying to address the root causes of why salespeople were choosing to leave, whether it was we were hiring the wrong people or we had the wrong incentives in place.

So we've addressed some of those things. I think it's too early to say whether what we've done so far will prove to be successful. I think the faster we grow volume the more likely it is that a salesperson will stay because they are successful and they are making money. Mid-last year when we weren't growing quite as fast, it was a bigger challenge. But we are only through now almost four months of the year, and I think we need to see a few more months play out before we say we have the attrition problem corrected.

David Henle: OK, thank you.

Operator: Our next question comes from Daniel Smith of Teton Capital, your line is open.

Daniel Smith: Hi guys, great quarter. I think one thing you've said in the past, and this may not be true so don't let me put words in your mouth, is that profit per loan is more important to you than spread. And if that's true, why is – and you guys are compensated basically on return on capital. So if that's true, why is that better for your compensation and for stockholder returns?

Brett Roberts: First, I think the way that we are compensated is aligned with shareholder returns. It's not just profit per unit. It's profit per unit including a cost for our equity capital. And it's profit per unit times the number of units that we write. So we're trying to maximize that equation. And so what that means is that at a certain level of return or profit per unit, you are willing to make a trade for less margin and more volume. And the opposite is true as your margins get skinnier.

So I think what that has done over a long period of time is it has focused us on the right things. I think it causes our return generally to be a lot higher than what you would see in the rest of the industry, which I think has been a positive thing for shareholders. And it just gives us a consistent way to price and think about the business, whether it's a tough competitive environment or an easy competitive environment. We always price the exact same way.

Daniel Smith: So when you move out the duration, does a longer-duration loan tend to have a higher spread or a lower spread, or is there any difference?

Brett Roberts: The way it's presented in the table, the longer term loan will generally have, for the exact same customer, a lower collection rate. So, everything else on the deal consistent, if you move the term out the collection rate is going to drop. And that's reflected in our forecast. So if the collection rate drops, typically the lower the collection rate the lower the spread.

Again, because of the way the table is presented it's one minus the other, not necessarily one divided by the other. You get a little bit different look at it if you take the forecasted collection rate divided by the advance. But the way it's presented, the spread would typically shrink on a longer-term loan for the same customer.

Daniel Smith: So that's the root of my question is if the spread goes out and just factually your duration is lengthening, so as the spread declines and the turnover rate of the loans declines, does that mean that the portfolio, all else equal, is going to a lower return on capital because of the lengthening duration, ignoring all other factors?

Brett Roberts: I think if you look at the trend in our income statement you would see that the revenue yield or the finance charge yield, whichever one you want to look at, has been declining over time. And the business we are writing today, assuming there is no positive forecast variance going forward, has a lower yield than the business that's on the books already.

Daniel Smith: Is that solely because of competitive forces? Or is that something – is there some element of conscious effort that you are doing that? Because – well, I'll just let you answer that.

Brett Roberts: Well, it's a combination of both. Certainly, if there were no competition our returns and our yields would be a lot higher. So clearly, we have to price with an eye toward the – in the market that we are in, we have to take that into consideration. Clearly, our pricing is a function of the competitive market. It's also a function of trying to maximize that equation that I talked about.

Daniel Smith: Right. OK, so just to focus on that part, the conscious maximization, I'm just trying to understand. Based on what you said so far, I'm just trying to understand your perspective, why you think that it can be good to lengthen duration.

Brett Roberts: I think – the criteria we used to decide whether it's good or not is the one I described where we are trying to maximize the equation of volume and profit per unit. So typically a longer-term loan will be a larger loan, which is an advantage. If you have the same return on a larger loan your profits are higher. You have deployed more capital at the same return. It will typically have a lower return, however. So that works in the opposite direction.

So you need to decide whether the volume that you are generating is enough to make up for the lower return and the combination of the lower return and the larger contract size. So we work through the math of that. We do it very carefully. We make sure that any changes we make are positive ones, and we feel comfortable that in this case it's very likely that the lengthening term is a good thing for shareholders.

Daniel Smith: OK. So essentially your bonus or your option vesting is based on return on capital. Now, there is a cost of capital. But when you say you make a larger loan, that isn't necessarily good for return on capital. Right?

Brett Roberts: Again, it's not – if I'm not being clear, it's not a return on capital incentive plan or a return on capital focus. It's what we call economic profit, which – certainly, return on capital is an important component of that. But it's not the only thing. Economic profit is the return we make over our cost of capital multiplied by the capital we have invested in the business. So is it better to have a $1 billion business at a 15 percent return or $3 billion business at a 14 percent return? It takes into consideration, the size of the business and how much capital you are employing along with the returns that you are employing it with.

Daniel Smith: So basically you are just saying as long as you have available capital it makes sense to deploy it as long as it's economically profitable?

Brett Roberts: That's certainly true. But the way we think about it is, at what price do we generate the best combination of volume and profit per unit, and what policy generates the best combination of volume and profit per unit. And by policy, term policy is one of those.

Daniel Smith: Alright, thank you.

Operator: Our next question comes from Clifford Sosin of CAS Investment Partners, your line is open.

Clifford Sosin: Thank you for taking my question. Obviously, productivity by the salesforce improved year over year in these last few quarters. Can you discuss the distribution of that improvement amongst your salespeople? In other words, was it fairly evenly distributed; that is to say, most salespeople saw a similar increase in performance? Or did you see perhaps an improvement in maybe the bottom two quartiles of the salesforce, which might be may be an indication of either a learning curve or a cycling through to better people, driving salesperson productivity?

Brett Roberts: I think the best answer to that is the performance of the salesperson varies dramatically. Your top salesperson grows much faster than your average or your bottom. And it's a wide disparity. It always has been. So it's not as if everyone is performing at about the same level and they all went up by 28 percent. With 235 salespeople, the difference between number one and number 235 is a vast difference.

In general, we have been successful in our better markets. I know that the markets we are most successful in grew faster than the markets where we have had less success. What I take from that is I think there is a little bit of momentum that develops in a market, that sometimes the first dealer that you sign up is the toughest in a market because nobody knows who you are and you can’t point to dealers in the area that have had success on your program.

But then once you get a critical mass in a market and you have a lot of dealers using your program and enjoying success, it's sometimes easier to grow it from there. So I think the performance by salesperson probably reflects that dynamic as well as the skill and experience and ability of the individual salespeople, which obviously varies as well.

Clifford Sosin: That's very helpful. And then secondarily, you had a tremendous amount of success, obviously, with these slightly longer-termed loans. Obviously, the risk with longer-term loans is that to the extent they underperform your expectations, the magnitude of underperformance can be bigger, given the term.

Do you factor that into your cost of equity considerations when you are considering the marginal economic profit of a loan? In other words, maybe a better way for it is, how do you factor in the probably greater amount of risk in a longer-term loan into the cost of equity that you use when calculating the economic profit for such a loan?

Brett Roberts: The term of the loan doesn't affect our cost of equity is the simple answer.

Clifford Sosin: OK, thank you, guys.

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 the 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 does conclude today's conference. We thank you for your participation.

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