CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
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Operator: Good day, everyone. Welcome to the Credit Acceptance Corporation Fourth 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, Tricia. Good afternoon and welcome to the Credit Acceptance Corporation Fourth 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 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: Ladies and gentlemen on the phone lines, if you would like to ask a question at this time, please press star followed by the number one key on your touchtone telephone. If your question has been answered and you wish to remove yourself from the queue you may press the pound key.

And our first question comes from the line of Kyle Joseph with Jefferies. Your line is now open.

Kyle Joseph: Afternoon, guys. Congratulations on a good quarter and thanks for taking my questions. I just want to get your thoughts to start on competition, given broader macroeconomic volatility. Have you seen any pullback in competition and what's your outlook for 2016?

Brett Roberts: The best way to get a sense for the competitive environment for us is to look at volume per dealer. The volume per dealer for the quarter increased by 3.8%. That's less of an increase than we saw in prior quarters of the year but we did have a tougher comparison as the fourth quarter of the prior year we started to grow the business. Beyond that, I think as long as there's capital available to the market we'll continue to see lots of competition. It is very competitive right now. It has been for some time, but in terms of an outlook it's really hard to say. I wouldn’t look for much of a change until capital dries up for the industry.

Kyle Joseph: Got it. Thanks. That's helpful. And then in terms of your collections forecast, it looks like the forecasted collections came down a couple basis points for some of the vintages. Is that primarily driven by the term extension or is there anything going on in terms of frequency or severity you guys want to highlight?

Brett Roberts: I think at a high level we provide our initial forecast for each of the last 10 years. We update that forecast every quarter. For 8 of the last 10 years we've had a positive variance against our initial forecast. The only two years where the variance was negative were 2006 and 2007 that were affected by the financial crisis and those are probably noteworthy just because the variance, even though it was negative, was very small given the change in the environment that we experienced. Recently we saw a few basis point moves for a few of the years, a positive move for 2015, but in total the total cash flows really didn't change by much versus our forecast.

Kyle Joseph: Got it. Thanks. And lastly, can you talk to us about what you're seeing from the ABS markets in terms of new issue spreads you guys are seeing and your outlook for your cost of funds?

Douglas Busk: The conditions in the ABS market aren't dramatically different than we saw in the latter part of 2015. Investors are being selective. There is definitely some tiering going on in terms of public versus 144A, prime versus sub-prime, and then tiering based on the financial strength of the sponsor. We did our last deal in August of 2015, which had an all-in rate including issuance fees of about 3%. It's a little difficult to tell but if we were to access the 144A market today and do a similarly structured fixed-rate deal, we'd think we'd be right in the 3.5% range. So a little more challenging environment, but things are still getting done. The 3.5% issuance, since it would likely be a small portion of our overall debt and is less than our overall weighted average cost of funds, would have a minimal impact on our overall cost of funds.

Kyle Joseph: Great. Thanks very much for answering my questions.

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

David Scharf: Yes, thanks for taking my questions as well. First one relates to the dealer count and I guess it's a follow-up to the question on competition. It's still a very strong year-over-year growth in active dealers. Should we be viewing this as largely a function of just the maturation of all the sales people you've added over the last few years or are you finding there are a lot of new dealers who are coming onto your system because they can't get deep sub-prime borrowers financed?

Brett Roberts: It's a combination of the two. We have a very small market share currently. There's a lot of dealers out there that could use our program and benefit from it that don't have it currently. We would like to think that we have lots of room to continue to grow our active dealer count. We made some progress on that this quarter.

David Scharf: Is the year-over-year growth rate you've been delivering in calendar 2015 a level that you think is sustainable this year?

Brett Roberts: I think it's difficult to predict short-term growth rates either in dealers or unit volumes. If you look at our long-term track record, when we've had capital we've been able to grow the business pretty nicely and we hope that will continue but again, it's hard to predict the future.

David Scharf: Got it. Got it. Shifting to the revenue side in pricing, I might not have caught it, is there an average yield for this quarter?

Douglas Busk: There isn't one disclosed. We typically disclose that in the 10-Q. Our GAAP revenue for the quarter was about 25.5%. Our adjusted yield was about 24.7%.

David Scharf: Okay. And just, Doug, so I'm clear, is the 24.7% comparable to the 25.8% last quarter?

Douglas Busk: The GAAP number you're referencing is 25.7%, which was the GAAP yield in the third quarter last year. The 25.6% GAAP yield is comparable to that number.

David Scharf: Got it. Got it. It looks like the advance rate came down sequentially, noticeably effectively raising pricing. Is that anticipation of kind of a lower collection multiple going forward? I mean, is that—should we be viewing that as effectively an effort to maintain the existing effective yield in unit economics or should we be viewing that as an absolute price increase?

Brett Roberts: No. We didn't change prices during the quarter, so the lower advance rates just reflects the lower forecasted collection percentage.

David Scharf: Okay, so relatively flattish yield should be the outlook. And then the last question is on the operating leverage side. It looks like it's another quarter in which G&A held pretty steady under $10 million. Based on everything you know about initiatives internally for 2016, should we still be looking at $40 million or less on an annualized basis as a reasonable target?

Douglas Busk: It's a little difficult to say. I think it's obvious we've benefited from operating leverage over time as the business has grown. If you look back at our historical results, you'll see that operating leverage is lumpy. Some periods we make a lot of progress, some periods less so. We think there is still opportunity for operating leverage in the business going forward, but I think the timing of that is very difficult to predict.

David Scharf: Okay. Fair enough. And then just last question. The provision expense on the GAAP basis comparable to last quarter, basically the under-performance of some pools for level yield accounting, were they concentrated in any particular vintage?

Brett Roberts: I think that the provision is not something we really focus on internally. We tend to focus on the adjusted results and that way you don't have to worry about the provision expense. We don't view it as a real expense. As we've talked about in the past, if your cash flow forecast overall doesn't change at all you can still record a provision. The larger number you report, the more it's going to flip around in future periods so we just look at the adjusted numbers internally and we don't pay a lot of attention to the provision.

David Scharf: Got it. Thank you.

Operator: Thank you. And our next questions comes from the line of Christopher Crum with AYL Stone Company. Your line is now open.

Christopher Crum: Hi. Yes on the buyback, how many shares did you repurchase in the quarter?

Douglas Busk: We bought back 464,000 shares at a cost of approximately $85.5 million.

Christopher Crum: And was the repurchase authorization unanimous from the Board?

Douglas Busk: Yes.

Christopher Crum: Okay. And then I guess the final question, I noticed that Donald Foss sold $100 million worth of stock. Just kind of wondering why he would authorize a repurchase at the Board level and sell personally?

Brett Roberts: I don't know that he sold $100 million worth of stock.

Christopher Crum: He filed a Form 144.

Brett Roberts: That's new information to me if he sold $100 million worth of stock. But regardless, the decision of any individual to buy or sell stock can be very different than for the Company. We look at the share repurchase as something we've done for a long time. It's really a way to deploy excess capital, similar to a dividend. Our policy is to buy it back only when the Board believes it's below intrinsic value but that's a different criteria than what an individual might need cash for or diversification. There's lots of reasons an individual might sell that wouldn't necessarily reflect the Board's decision.

Christopher Crum: Thank you.

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

Robert Dodd: Hi, guys. Thanks for taking the question. If I can look at the allocation or spread between dealer loans and purchase loans, purchase loans ticked up a bit in the quarter positively on both forecast collections and spread. Dealer loans moved a little bit the other way. The overall mix, obviously the spread ticked down a little bit, 30 basis points in the fourth quarter versus where it was in the third. Is that a function of the mix that you're doing at the moment, more purchase loans versus dealer loans in the fourth quarter, and then does that itself have any connection to the increased term that the average purchase loan maybe has a longer term than a loan you guys would originate directly?

Brett Roberts: We're doing a little bit more purchase business now. It's still low relative to where it's been historically. As we've talked about in prior calls, we just view that as a different channel for us. We do prefer the portfolio program because of the alignment of interest it creates because a significant piece of the dealer's profit is paid out over time based on loan performance.

It sets up a situation that's unique in our market where the dealer, the customer and Credit Acceptance can all succeed together so we do prefer that program. Having said that, there are dealers that for one reason or another aren't interested in our traditional portfolio program, and so in recent periods, we began to view that as a separate channel that we want to take advantage of and that channel's been growing.

Robert Dodd: Okay. Thank you.

Operator: And our next question comes from the line of Lucy Webster with Compass Point. Your line is now open.

Lucy Webster: Hey, good afternoon, guys. My first question, can you talk about maybe the sort of average age of the vehicle behind your managed portfolio or just do you have exposure to a certain age within the sort of aggregate used vehicle car market that you can talk about?

Douglas Busk: We don't disclose the average age of our vehicles. What we try to do is boil every aspect of the loan structure, consumer bureau, application and vehicle information down into one number and that's the forecasted collection rate on each loan. We publish that when we book the loan and every quarter thereafter. We try to just take it up a level and give you the most important number.

Lucy Webster: Okay. And then my other question was about the 3,400 new dealers that you added over the course of this year. I'm just wondering can you talk about or give us any color on what's in that new active dealer number? It just seems like if you have over 9,000 active dealers at the end of the year, what do you guys think about sort of your total addressable market in terms of potential new dealers going forward given there's obviously a finite amount of used car dealers in the U.S.?

Douglas Busk: I mean, there are about 60,000 used car dealers out there. We did business with a little less than 7,000 of them last quarter. So obviously we have, whether you look at our market share in terms of percent of sub-prime or deep prime consumers that finance a vehicle, or in terms of dealers, we have a very small share of the market. At some point, that will start to be a concern but I think we're a very long way from that being an issue for us.

The other thing I'd point out is neither our active dealer number nor the number of dealers in the United States is a static number. There's lots of turnover in both of those numbers. So we think we have room to grow our dealer base and grow our business for the foreseeable future.

Lucy Webster: Great. That's all for me. Thank you, guys.

Operator: Thank you. Our next question comes from the line of Randy Heck with Goodnow Investment Group. Your line is now open.

Randy Heck: Hi, Brett, Doug. Really, really terrific quarter and thanks for taking my call, or my questions. I'm guessing that people are going to again wonder whether the declining spread in the business is something to worry about. I was hoping you could just talk about what that means in terms of the absolute spread between your advance rate in your estimated collections, how that's less important than the estimated return on the capital employed with a given advance rate.

Well, I think this spread in the most recent period is probably as low as it's been since 2007 and yet in the fourth quarter of 2007, I believe you earned something like $0.40. This quarter you earned $4. So how do we get from $0.40 to $4 when the spread is the same? And then I have a couple follow-up questions.

Brett Roberts: I think you raise a good point. The spread as it's presented in the table, just the forecasted collection rate minus the advance rate is lower than it had been. The way it's presented it's about where it was in 2006 and slightly higher than 2007. Taking one minus the other works pretty well if the forecasted collection rate is about the same number. It doesn't work quite as well if the forecasted collection rate declines.

If you just want to look at that table a slightly different way and take the forecasted collection rate divided by the advance, you get a slightly different trend. What you would see is that 2014 and 2015 have a more favorable relationship between those two numbers than 2006 and 2007. Still the point that people seem focused on is that it's declined over time and you have to remember that some of the periods we're comparing it to, 2009, 2010, 2011, we had very limited levels of competition during those periods following the financial crisis.

So it's kind of an unusual period to compare it to and I think you also have to keep in mind that during the same periods, the after-tax returns that we were reporting were unsustainably high. I think in 2010 our after-tax unleveraged return was 17%, almost 18%, so the spreads have come down. The return has come down as well. And we weren't expecting 18% unlevered after-tax returns to continue forever, but we made a decision, like we do every period, to price to create the best combination of volume and profit per unit. That's the same way we've priced historically and so what you saw this year is that the spreads came down a little bit, but the volume was very, very strong and the blended result is one that we're very happy with, particularly given where we are in the competitive environment.

We do expect at some point in the future the competitive environment will change. We may have an opportunity to price more conservatively at that time but we'll continue to price based on what the market gives us and the results up through this quarter I think speak for themselves.

Randy Heck: Okay. Yes, I noticed your return on invested capital actually ticked up this quarter versus the third quarter, which I think it's been a while. Okay

Brett Roberts: The other thing to point out there, and this is probably obvious is, the other thing that's changed if you look at the period covered in that table from 2006 until today, is our expenses are obviously a lot lower. Our expenses as a percentage of capital were over 15% in 2006 and they were under 7% this past quarter and right around 7% for the year.

Randy Heck: Okay. Yes, that's very helpful. Just a follow-up. The other questions that I hear are generally, well what's happening to credit quality? What about this big provision and what about the 10 basis points here or 20 basis points there?

Can you just discuss how the cross-collateralization of loans by each dealer diminishes or dilutes the impact of changes in collections, not to mention how changes in things like repossession values of cars, dilutes or diminishes the impact to your bottom-line number?

Brett Roberts: Right. The advantage to our model is if we -- we have had a pretty good history of having positive variances against our initial forecast, but if there are negative variances, those are shared with the dealer 80%/20% so if we miss our collection forecast by $1 million, $800,000 of that goes to dealer holdback and the impact to us is only $200,000. So as we saw during the financial crisis, when we had some negative variances it really had very little impact on our profitability because of that 80%/20% split and that risk-sharing arrangement we have with the dealer.

The other thing to keep in mind is when you look at the forecasted collection percentages, you've got to ask yourself what's a material number? And I would argue that all the numbers on the page with the exception of maybe 2009 when we had a 750 basis point positive variance, they were all immaterial.

We'd like to have a positive variance there. It's a nice surprise to see some extra income coming through from a positive change in your forecast, but it's not really a big driver of our overall financial results.

As an example for the quarter, we had some negative numbers in the table. I think the total change in our forecast related to just the collection line, forgetting about the 80%/20% split and the holdback, was just a little bit over $6 million. Is that a big number?

The total forecast is almost $5 billion, so it's about a 13 basis point change and 80% of that was borne by the dealer. So none of the numbers in the table are really that concerning since they are all very small. We'd love to have a 750 basis point positive variance every year but obviously our forecast wouldn’t be very accurate if we continue to have that kind of performance.

So we're positive for the last eight years. We're happy with that and we don't really see much concern there.

Randy Heck: Again, great year and good luck this year.

Brett Roberts: Thanks.

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

David Henle: Good evening. Could you guys just spend a minute on the sales force and obviously relative to dealer growth that was -- that's been great in this quarter and in prior quarters. I'm just curious, have you been tweaking the commission rates and do you continue to do that? Are you still fine-tuning that and can you spend a little bit of time on how you feel about the sales force and retention of the sales force?

Brett Roberts: I think we made good progress there as we've talked about in prior calls. We grew that sales force very rapidly and we experienced some growing pains with that. We had turnover that was higher than we would have liked. We had more new hires than we would have liked that didn't perform up to our expectations but that's gotten a lot better now. We've done a lot of fill in. We've gotten better at hiring the right people. We haven't changed the incentives since the fourth quarter of 2014. We changed the base salaries then but the incentive piece has remained the same for quite a while.

David Henle: Have you ever disclosed the retention rate for the sales force or not?

Brett Roberts: No.

David Henle: You haven't. Okay. And last question, was there any change in the stated length of loans in fourth quarter versus third quarter?

Douglas Busk: It was very, very, very modest. In the press release we compared the term of a loan in the fourth quarter of 50.4 months to 49.7 months for loans assigned in the first nine months of 2015 so that doesn't directly answer your question about the third quarter but it will get you in the ballpark.

David Henle: OK, got it. Thank you. That's it for me.

Operator: Thank you. Our next question comes from the line of John Rowan with Janney. Your line is now open.

John Rowan: Good afternoon, guys. Just wanted to go back quickly to the conversation of holdback and negative variance and how any type of negative variance affects the dealer. I'm just curious, with a couple of negative marks in the last couple of quarters, are your dealers bearing any type of real brunt to their holdback and when do you foresee that you may get some type of pushback from the dealers who are getting smaller and smaller holdback checks?

Brett Roberts: I think if you look at the table, eight straight years we've had a positive variance there, so I don't think there's any negative ramifications to be concerned about with the dealers.

John Rowan: Okay. And then, are you aware of any platforms out there that are ready to go, kind of waiting to be operational now that your CAPS system has lost its patent? I don't believe that the royalties you receive on that are material but I just wanted to know kind of competitive, which one of your competitors have platforms up and running and which ones do you think will try to get something up and running?

Brett Roberts: I don't think that we have good visibility to that question. There's thousands of lenders that are willing to write a sub-prime loan. I don't think we'd have visibility in terms of how many of those thousands have systems that are out there or have systems that are planned. We just don't have that good of visibility.

John Rowan: Okay. Thank you.

Operator: Thank you. Our next question comes from the line of Sanjay Sen with Bloombergsen. Your line is now open.

Sanjay Sen: Hey, Doug, Jeff. Congratulations on a great year. I had a question I wanted to ask you on the purchase versus dealer loan programs. But before that, I looked through the filings. I follow them all the time. I haven't seen any $100 million sale of stock by Don Foss. That's just incorrect.

But if you can talk a bit more, Brett, because we've been wondering about this issue of how the purchase loans don't have the same alignment so how do you think of those loans in mitigating risk while taking the opportunity there?

Brett Roberts: It's a good question. I think we've been doing it for a long time so I think we're comfortable with our procedures there. You have to be a little bit more careful about the dealer that you do business with. You have to be a little bit more conservative about your collection forecast. You have to have some different risk management procedures in place, but we've been doing it for a long time. We've had positive results, as I said. We like the portfolio program better, but the purchase business is still good business. It's priced to achieve a very high return, and we're happy to do more of it.

Sanjay Sen: So there's no sort of limit in your mind as to how big it would be or is there -- how do you think of that?

Brett Roberts: There'd be a limit there but again, the portfolio program is the more popular program by a large margin so that's not something that we spend a lot of time thinking about just because it's something we will address if it ever becomes a concern in terms of its size.

Sanjay Sen: Got you. Right. Historically, you've talked about, I think in the last little bit, a leverage ratio of 2 to 2.5. Obviously, you're willing to increase that a little bit here because of the stock and the buyback. Anything you can add to that in terms of how you think of the leverage ratio in light of what the stock is right now? Would you want to be at the higher end because you think the stock is cheaper or are you just going to play it by ear?

Brett Roberts: We don't really look at the debt-to-equity ratio as a strict limit. The way we do it is we run financial projections where we assume that the capital markets close for a period of time and we look at what the impact would be to our originations and we select a scenario where we're happy with the worst-case scenario, where if the worst happens and there's no capital available that we can still live with those results. So that's more how we do it.

You're right, we have been kind of between 2 to 2.5 to 1 over time. We're currently right in the middle of that range so we're comfortable where we are. In terms of share buybacks, we will continue to apply the same thought process we have in the past. First priority is capital that can be used in the business and when we have excess capital, we think about buying back shares if the price is attractive

Sanjay Sen: Got you. Thanks. Great work.

Operator: Thank you ladies and gentleman, if you do have a question at this time, please do press star, then one on your touchtone phone.

Our next question comes from the line of Moshe Orenbuch with Credit Suisse. Your line is now open

Moshe Orenbuch: Great, thanks for taking my question. Kind of a follow-up on the competitive dynamic. Couple of the large players this quarter talked about slowing down in the sub-prime, Cap One, they said that they've been flattish for a long time and kind of went down and then Santander Consumer also. You referenced kind of a reversal, something that would cause a retreat of capital. What sort of thing could cause that? Do you think it's starting? Could you just maybe amplify on that whole discussion a little bit?

Brett Roberts: I think it's hard to say. It's been different each time. In the mid-1990s capital moved away from the industry because of industry-specific concerns, which in retrospect turned out to be right.

At other times it's been more macro issues that have caused capital to leave the industry. I think it's really hard to say. Each time it's been a little bit different. But eventually I think if companies don't perform and if loan performance and profitability is not there for the industry that would certainly be one reason why capital might decide to pull out but there could be other macro reasons as well.

Moshe Orenbuch: But you're not feeling that you're at that point yet here?

Brett Roberts: I don't think that's happened yet.

Moshe Orenbuch: Thanks so much.

Operator: Thank you. Our next question comes from the line of Lucy Webster with Compass Point. Your line is now open.

Lucy Webster: Hey, guys. Sorry if I missed this. Have you ever talked about what percentage of dealers you are working with today are eligible for holdback payments?

Brett Roberts: It would be all the portfolio dealers.

Douglas Busk: Yes.

Lucy Webster: Would they have to complete at least 100 loans.

Douglas Busk: There is. They have to. On the portfolio program, they have to complete 100 loans before they're eligible for dealer holdback. You know the problem with answering your question is for those dealers sort of around 40, 50, 70 you can't say definitively that they won't be eligible for dealer holdback at some point.

Lucy Webster: Okay. Understood. Thank you.

Operator: Thank you. And with no further questions in the queue, I'd like to turn the conference back over to Mr. Busk for any additional or closing remarks.

Douglas Busk: We'd 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 with you again next quarter. Thank you.

Operator: Once again, this does conclude today's conference. Thank you for your participation.

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