CREDIT ACCEPTANCE CORPORATION

Moderator: Douglas Busk
May 1, 2017
5:00 p.m. ET

Operator: Good day, everyone and welcome to the Credit Acceptance Corporation First Quarter 2017 Earnings Conference 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, Bryan. Good afternoon and welcome to the Credit Acceptance Corporation First Quarter 2017 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 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 sir. Ladies and gentlemen, at this time, if you would like to ask a question please press star and then one on your telephone keypad. If your questions have been answered or you wish to withdraw from the queue please press the pound key.

Our first question will come from the line of Jack Micenko from SIG. Please proceed.

Jack Micenko: Hi, thanks for taking the question. Looking to dollar volume, it continues to grow, and I'm wondering, is that a function simply of the longer term and maybe some of the purchase program mix shift or are you doing something strategically where you're looking at maybe a newer collateral, something along those lines around the average loan size and that sort of thing?

Brett Roberts: Yes, it's all of those. It's just a mix shift, we've written those loans before, and we're just writing larger, longer term loans that we had previously.

Jack Micenko: Okay, and then the increase in servicing expense, is that portfolio growth-driven, is that compliance driven or is that sort of a follow-on to sort of tightening some standards last quarter?

Brett Roberts: No, it's strictly related to the growth of the portfolio. The servicing expenses grew slower than the portfolio grew.

Jack Micenko: Okay, thanks.

Operator: Thank you. Our next question will come from the line of David Scharf with JMP Securities. Please proceed.

David Scharf: Yes, good afternoon. Thanks for taking my questions. Just curious thinking about the environment you encountered year-to-date. I think last quarter, you made the comment that competition was the biggest hindrance of volumes, not demand. Is that still the case, would you still rank competition as a bigger headwind, if you will, than overall consumer demand or are we seeing any changes in the latter?

Brett Roberts: No, I think it's hard to separate the factors. I think in my mind, the two biggest factors are competition and then the changes we made to address the loan performance issues.

David Scharf: Okay. On the competitive side, can you give us maybe some qualitative feedback on whether or not there are any signs that we may be at a peak; that it might start to ease? Doug, I know when we talked, you have your hand on the pulse of the ABS markets all the time. Is there anything on the funding side that leads you to believe on the margin that maybe by the second half of the year, some of the smaller lenders may have a little more difficult time; trying to gauge whether or not it's sort of the peak of competitive forces and that maybe things are set to turn around later in the year?

Douglas Busk: Well, speaking relative to conditions in the capital markets, certainly nothing that we're seeing at this point that would indicate that the ABS market is less available to the industry than it has been.

Spreads were very attractive in Q1. They have widened a bit since then, but are still at relatively attractive levels. So, certainly, nothing on the funding side.

David Scharf: Okay. So, just so I understand it, there is nothing there that indicates some competitors may have a more difficult time accessing capital near term?

Douglas Busk: Nothing significant from a capital markets perspective that I am seeing at this point.

David Scharf: Okay, got it. A couple of quantitative questions; the tax rate, was there anything or any kind of one-time benefit, like a state refund or anything that brought the rate down this quarter and how should we think about that for the full year?

Douglas Busk: There was a change in the first quarter this year relative to adopting a new accounting standard. Historically, the difference between the tax deduction we get when our restricted stock vests or restricted stock units convert to common stock, the difference between that and amount of the GAAP expense we recorded has historically just been recorded as a direct entry to equity. Beginning in the first quarter of this year, those excess tax benefits flow through the tax line and that's what accounted for the difference in the effective rates.

David Scharf: Got it. Was that a true-up? Should we be thinking about roughly 37%, 38% going forward?

Douglas Busk: It wasn't a true-up, it related to the activity that occurred in the quarter. And I think you can go back and there is some seasonality; that activity tends to occur most often in the first quarter of each year.

But other than that, pending anything that comes out of Washington, I think we're still thinking about our effective tax rate the same way, 35% for federal, a couple points for state and then whatever adjustments like this you might have.

David Scharf: Got it, got it. And then lastly just on the collection front, it looks like in the forecast revisions in the quarter, the 2015 vintage came down again, but 2016 was revised up slightly. I'm not sure what in the first quarter got revised up but I'm wondering, can you give us a sense in order to interpret this as, "Hey, maybe we sort of passed through the toughest period," like as we think about forecasted collections during this calendar year, what percentage of those collections will be accounted for by the '16 and '17 vintages or maybe alternatively how much of less of a factor in this year's collection are the 2014 and '15 vintages?

Brett Roberts: That's one way to look at it. I think the simplest way to look at it is the table on Page 2 of the release where we just quantified the dollar amount of the change in the net cash flow forecast.

David Scharf: Yes.

Brett Roberts: It was a positive $8.1 million this quarter, negative $6.7 million for the same quarter last year, and the $8.1 million is on $5.5 billion of undiscounted net cash flows. So, a very small move this quarter and a very small move same quarter of last year. So, you can break it down by year, but you're talking about a very small change in total.

David Scharf: Got it. And it looks like the ending allowance rate was unchanged as well by and large. Okay, very helpful, thank you.

Operator: Thank you. Our next question will come from the line of John Hecht with Jefferies. Please proceed.

John Hecht: Yes, thanks very much. Yes, I'm wondering if you can tell us, I mean you can all see the actual -- I guess the actual metrics. I wonder if you could maybe talk about the changes you had over the past two or three quarters on the loan-to-value and duration in both the dealer loans and the purchased loan pools?

Brett Roberts: The loan term is disclosed. You can see we've got a little bit longer this quarter. We don't disclose loan-to-value. But as we've talked about with the term, it's a mix issue. We write loans with terms of 24 months up to 72 months. For about 80% of the loans we write,we have a full amortization period behind us. We've got a full history on how those loans will perform.

And for the 66-month and 72-month loans, we don't have a full history. I think we're about 75% of the way through the 66 months. So, we have 48 to 50 months of history there. And on the 72, we have about between 24 and 30 months of history on those.

So, we feel like for most loans we write, we've got good data to back it up. For the 72-month loans, we have to do a little bit of estimation, so there's a little bit more risk there. But because we've got a lot of 60s and lot of 66-month loans on which to base it, we don't think it's a stretch to be able to forecast those with a high degree of accuracy.

John Hecht: Okay. And then lot of discussion and focus now on the changing used car values, residual values and so forth. I'm wondering just if you give us your opinions on kind of where you see the pace of that -- the trajectory of used car values and then how that impacts your business overall?

Brett Roberts: So, it's no secret that the vehicles are depreciating faster than they have, going back to probably 2008 as the last time we saw an environment like this. So it's no surprise to anyone as some of it has been predicted. It's definitely coming true. Vehicle depreciation is much steeper now than it has been since 2008.

As we talked about in the past, it doesn't have a huge impact on our business. And we tend to think about things like this long term, so we'll be in periods where vehicle values are helping in terms of the depreciation curve, and we'll go through periods where it's more severe like it is today, and it all evens out over time.

The difference for us between the worst end of the spectrum over the last 10 years and the best end of the spectrum is about 300 basis points, in terms of the collection rate. And that's not insignificant, 300 basis points, but in the scheme of things, when you look at the high and the low over a 10-year period, it's really not that significant.

What we try to do, instead of trying to put a perfect forecast on where vehicles values will be in the future, is we try to originate business with an expected return well above our cost of capital so that even if collection rates come in a little bit lower than we anticipated, the business we're writing is still very profitable.

John Hecht: Okay, I appreciate the color, thanks very much.

Operator: Thank you. Our next question will come from the line of John Rowan with Janney. Please proceed.

John Rowan: Good afternoon, guys. Doug, just going back to your prior comment that the ABS spreads have widened out post-1Q, obviously, one of your competitors in the market a couple of weeks ago had a pretty widening spread in the bottom tranches.

Do you think that's a one-off situation with the placement of that deal or do you think that's a trend that we might actually see investors place lower demand on bottom tranches of ABS deals?

Douglas Busk: It's a good question and it's a little bit tough to say because there hasn't been a lot of subprime auto issuance real deep in the capital stack over the last few weeks. Certainly, spreads have widened out in general a little bit but the widening has been much more extreme on the BB and BBB tranches than it has on the higher-rated tranches. So, I think at this point, it's a little bit premature to conclude on that point. We'll just have to watch subsequent issuances and see what happens.

John Rowan: Okay. And then last quarter call, you guys talked about hitting a point of resistance to growing dealer partners. Obviously, you grew them this quarter. Would you label the same kind of characterization this quarter or are you getting more bullish messages from your sales staff? I just want to gauge any incremental shift in that opinion?

Brett Roberts: I think the numbers speak for themselves, and we did grow the dealers but we didn't grow very rapidly. The growth rate was slower than last quarter so I think the numbers captured how we feel about it. We'd like to be growing a little bit faster than we are, but in the last two quarters that's the best we've been able to do.

John Rowan: Okay, thank you.

Operator: Thank you. Our next question will come from the line of Leslie Vandegrift with Raymond James. Please proceed.

Robert Dodd: Hi, guys. It's actually Robert Dodd. Just looking at the return on capital that you disclosed in that, if we look year-over-year, obviously, the adjusted net income plus interest expense at $110.2 million versus you get on $96 million, I mean we can do the ratios.

But when you look at the adjusted return on capital, obviously, compressed 100 basis points year-over-year, and that's the average across everything. Looking at the incremental versus last year, it looks like it's maybe around 7%, which is obviously compressing especially as your cost to capital is rising and we saw buybacks.

So, you just mentioned in response to the previous question that you'd like to be growing faster. I mean the question is, at this incremental return on capital, which is the thinnest we've seen in some time for you guys, what's your calculus on originating loans versus buying back stock versus holding back on some of the origination activity given the incremental returns you are seeing?

Brett Roberts: I'm sorry, I didn't really follow you. You said 7% at one point but I didn't understand what you're referring to?

Robert Dodd: If I look -- that's a simple -- the adjusted net income year-over-year grew 13.4, the capital base 783.9, the ratio there is 7%. So, that's basically the incremental return on incremental capital. It looks --

Brett Roberts: I can tell you we expect to make a much higher return than 7% on the business that we're writing. So, there is something wrong with your math there.

But in terms of how we price, I say the same thing on every call, we always price the same way and that's the maximized unit volume times economic profit per unit. And so, whether the competitive environment is favorable or whether it's difficult, we always price the same way and our plan is continue to do that. And if we can't invest all of our capital in the business then we look to send it back to shareholders either through repurchasing shares or through a dividend.

Robert Dodd: Okay, thank you.

Douglas Busk: The composition of the capital changes too obviously, I mean some of the business that was in the book as of the end of the first quarter of 2016 has run off. So I think that's the reason why doing the math that you are suggesting doesn't produce the right answer.

Robert Dodd: Okay, I appreciate it, thanks.

Operator: Thank you. Our next question will come from the line of Ben Weinger with 3-Sigma Value. Please proceed.

Ben Weinger: Hi. If the dealer drops out of the program before closing the 100-loan pool, what happens to those loans? Are they moved to the purchase program?

Douglas Busk: Yes, if that's their first pool and they have failed to complete a pool of 100, they would forfeit their right to the dealer holdback and those loans will be transferred to purchased loans.

Ben Weinger: Thank you, that's all I have.

Operator: Thank you. Our next question will come from the line of Daniel Smith with Teton Capital. Please proceed.

Daniel Smith: Hi, guys. Some of your competitors have talked about dialing back loan growth. And so I guess my question is, one, have you seen that; two, have you been able to adjust your borrower profile at all like credit score, debt service ratio, anything as a result?

Brett Roberts: We haven't made any significant changes to our loan policies. It's a very big market. If one or two people say they may be dialing back, we'll see, but through the first quarter, we certainly didn't see that in the numbers.

Daniel Smith: Okay, thank you.

Operator: Thank you. Our next question will come from the line of David Scharf with JMP Securities. Please proceed.

David Scharf: Hi. My questions have all been answered, thank you.

Operator: Thank you. And a reminder ladies and gentlemen, if you would like to ask a question over the phone at this time, please press star then one on your telephone keypad. Our next question will come from the line of Clifford Sosin with CAS Investment. Please proceed.

Clifford Sosin: Hi. My question pertains to the increased expenditure in the sales force. The release refers to some increased expenditure and increasing headcount in the sales force. Can you maybe spend a few moments describing your initiatives there?

Brett Roberts: We're in the process of expanding the numbers of salespeople that we have. The number at the end of Q1 was higher than the start of Q1 but a lot of those salespeople are new so we haven't seen much of an impact yet in terms of the unit volume numbers. But hopefully, as they become more seasoned, we'll see a positive impact from that.

Clifford Sosin: Thank you.

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 Busk: We would like to thank everyone for their support and for joining us on our conference call today. If you have any additional follow-up questions, please direct them to our investor relations mailbox at IR@CreditAcceptance.com. We look forward to talking to you again next quarter. Thank you.

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

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