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Q3 2024 CREDIT ACCEPTANCE CORP EARNINGS CALL

EVENT DATE/TIME: October 31, 2024 / 12:30PM UTC

CORPORATE PARTICIPANTS

- **Jay Martin** *Credit Acceptance Corp - Chief Financial Officer*
- **Kenneth Booth** *Credit Acceptance Corp - President, Chief Executive Officer, Director*
- **Douglas Busk** *Credit Acceptance Corp - Chief Treasury Officer*
- **Jeff Soutar** *Credit Acceptance Corp - Vice President and Assistant Treasurer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **Moshe Orenbuch** *TD Cowen - Analyst*
- **John Hecht** *Jefferies - Analyst*
- **John Rowan** *Janney Montgomery Scott LLC - Analyst*
- **Robert Wildhack** *Autonomous Research - Analyst*
- **Ryan Shelley** *Bank of America - Analyst*

PRESENTATION

Operator

Good day, everyone and welcome to the Credit Acceptance Corporation Third Quarter 2024 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’s Chief Financial Officer, Jay Martin.

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Thank you. Good morning and welcome to the Credit Acceptance Corporation Third Quarter 2024 Earnings Call. As you read our news release posted on the Investor Relations section of our website at ir.creditacceptance.com, and as you listen to this conference call, please recognize that both contain forward-looking statements within the meaning of Federal Securities 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, I will turn the call over to our Chief Executive Officer, Ken Booth, to discuss our third quarter results.

Kenneth Booth *Credit Acceptance Corp - President, Chief Executive Officer, Director*

Thanks, Jay. Overall, we had another mixed quarter as it relates to collections and originations, two key drivers of our business. Our 2022 vintage continued to underperform our expectations, and 2021, 2023, and 2024 also declined. Overall, a modest decline of 0.6% or $62.8 million in forecasted net cash flows. As we have previously communicated, historically, our models are very good at predicting loan performance in aggregate, but our models work best during less volatile times. The pandemic and its ripple effects created volatile conditions. Federal stimulus, enhanced unemployment benefits, and supply chain disruptions led to vehicle shortages, inflation, et cetera - all of which impacted competitive conditions. We've had larger-than-average forecast misses, both high and low, during this volatile period. But, because we understand forecasting collection rates is challenging, our business model is designed to produce acceptable returns in the aggregate, even if loan performance is less-than-forecasted. Despite the decline in forecasted collections this quarter, we believe we will continue to produce substantial Economic Profit per share in the future. Even our worst vintage, 2022, is still forecasted to produce Economic Profit. As I've explained in the past, we are less reactive to changes in competitive and economic cycles than others in the industry because we take a long view on the industry, price to maximize Economic Profit over the long-term, and seek to best position the Company if access to capital becomes limited.

Ultimately, we're happy we had the discipline to maintain underwriting standards during the easy money times of 2021 and especially 2022. While our market share was lower during those years, we believe this put us in a better position to take advantage of more favorable market conditions today.

During the quarter, we experienced strong growth and had our highest Q3 unit and dollar volume ever, growing our loan unit and dollar volume by 17.7% and 12.2%, respectively. This is our ninth quarter in a row with double-digit unit volume growth.

Our loan portfolio is now at a new record high of $8.9 billion on an Adjusted basis, up 18.6% from Q3 2023. Our market share in our core segment was 6.2% as of August 31, 2024. Our growth did slow during the quarter, likely impacted by our Q2 forecast changes that resulted in lower advance rates during Q3.

Beyond these two key drivers, we continue making progress during the quarter towards our mission of creating intrinsic value and positively changing the lives of our five key constituents: dealers, consumers, team members, investors, and the communities we operate in.

We do this by providing a valuable product that enables dealers to sell to consumers regardless of their credit history. This allows dealers to make incremental sales for roughly 55% of adults with other than prime credit.

For these adults, it enables them to obtain a vehicle to get to their jobs, take their kids to school, et cetera. It also gives them the opportunity to improve or build their credit.

We recognize that it's been a challenging time for our consumers impacted by recent hurricanes. As we have for many years, we are working with these consumers including suspending some of our collection efforts, to allow these customers to prioritize their safety and most urgent needs.

During the quarter, we financed 95,670 contracts for our dealers and consumers. We collected $1.3 billion overall and paid $71 million in portfolio profit and portfolio profit express to our dealers. We added 1,038 new dealers for the quarter and now have our largest number of active dealers ever for a third quarter, with 10,678 dealers.

From an initiative perspective, we are committed to improvement through our go to market approach aimed at providing product innovation and support to our dealers faster and more effectively than ever before. This requires teamwork, attention to detail, and an iterative process that attempts to make improvement every step of the way. This is a work in progress, but we are getting better.

We also continue investing in our technology team. We've improved our team's capabilities and are focused on modernizing both our key technology architecture and how our teams perform work with the goal of increasing the speed at which we enhance our product for dealers and consumers.

During the quarter, we received four awards from Fortune, USA today and People Magazine recognizing us as a great place to work. We continue to focus on making our amazing workplace even better. We support our team members in making a difference to what makes a difference to them. In connection with their efforts, we contributed to organizations such as 42 Strong, American Foundation for Suicide Prevention, Atlanta Area School District, Children's Hospital of Michigan, and Pure Heart Foundation.

Now, Jay Martin and I will take your questions along with Douglas Busk, our Chief Treasury Officer; Jay Brinkley, our Senior Vice President and Treasurer; and Jeff Soutar, our Vice President and Assistant Treasurer.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Moshe Orenbuch with TD Cowen.

Moshe Orenbuch *TD Cowen - Analyst*

Great, thanks. I appreciate the comment that you're confident that the returns are higher than your hurdle rates, but could you just spend a little more time on that idea? Because they're all based upon estimates and the estimates have been revised down for six quarters. So I guess the real question is how do you know and what is it -- are we going to be having the same conversation 90 days from now? How should we think about that?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Our estimates in our third quarter release represent our best estimates of how we believe these loans are going to perform in the future. That considers the underperformance we've seen to date on post-pandemic vintages. To your point about what do we expect to see in the future, I would say our forecasting models perform best during relatively stable economic periods, but as Ken said, are less accurate during periods of volatility like we've experienced since the pandemic.

The biggest declines we saw in the quarter related to the '21 to '22 cohorts. Tough to say precisely why these have continued to underperform, but we know there are likely multiple contributing factors, including that these loans were originated during a very competitive period, which generally hurts loan performance. Consumers purchased vehicles at peak valuations, vehicle prices subsequently declined, and then the impact of inflation. We understand that others in our industry have experienced similar or worse performance on these cohorts, so we don't believe this trend is unique to Credit Acceptance. As it relates to the '21 to '22 business we point out that this business is more seasoned. We've collected 81% of what we ultimately expect to collect on the '21 business, and 61% of what we ultimately expect to collect on the '22 business. Going forward, those cohorts are going to have less of an impact on our financial results.

What it’s going to have more of an impact on is our financials based on how our '23 and '24 loans perform because we wrote more business in those years and those loans are also less seasoned. Then, as we get into next year, it would be more weighted to what we write in '25.

Moshe Orenbuch *TD Cowen - Analyst*

Right. I guess, I would just maybe tack on to that the idea that it isn't so much about volatility. It's about different factors affecting what has driven consumer behavior in this cycle versus previous cycles. And I guess it just pushes me to this question - Is it an estimation problem or is it an actual underwriting problem? Have you thought about changing the way you actually underwrite these loans?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Let's say in our forecast, we continue to consider recent performance. So, as we're originating new loans, we've considered the underperformance that we've seen in these '21 and '22 loans. We've adjusted and lowered our initial estimates on those future loans to consider that so we believe we are considering the underperformance there. As I mentioned before, we don't believe this is a problem unique to Credit Acceptance; we believe we're seeing this across the industry. We’ll assess that quarterly moving forward.

Moshe Orenbuch *TD Cowen - Analyst*

And then just last one for me. You didn't buy back any stock in the third quarter or in October to date from the filing of the Q, it looks like. So can you just talk a little bit about capital? It looks like loan growth is strong but decelerated a little. Can you just talk about that?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

Sure. As we've said many times over the years, our first priority is to make sure we have the capital that we need to fund the business. If we feel we have excess capital, then we'll take a look at the stock price. If we think we can buy it for less than intrinsic value, we'll return capital to shareholders. For most of Q3, we had higher outstanding balances on our revolving credit facilities than we customarily do.

Now, that situation was remedied at the very end of September when we did a relatively large ABS deal. So given the fact that we had more revolver usage and the leverage at the end of Q3 is at the high end of the historical range, and given uncertainties about collection performance and capital market conditions in light of the election, we took a bit more of a conservative approach. As you know, we've repurchased a significant number of shares over a long period of time - Over 30 million shares - since the late 90s, but we don't do it consistently. Some periods we buy back a lot, and some periods we buy back very little so I don't think that you can take a look at one quarter and assume that's the basis for a new trend line.

Moshe Orenbuch *TD Cowen - Analyst*

Got it. Thanks so much.

Operator

Our next question comes from the line of John Hecht with Jefferies.

John Hecht *Jefferies - Analyst*

Good morning. Thanks.

Operator

John, you may have muted your line.

We have a question from the line of John Rowan with Janney Montgomery Scott.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Good morning. I guess I just wanted to drill down a little bit into what lower consumer prepayments means. We've asked on the call before if that related to lower repossession or lower wholesale after repossession. But I guess drill down a little bit like what is it? Are you not getting the judgments you need when you go and you sue someone for a deficiency? Is it just consumers not paying on older debts that are in the tails, or has there been just a wholesale change in the number of consumers who are defaulting on loans? So, I'm just trying to get a better understanding of what that fairly generic term means.

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

It's primarily referring to consumers refinancing their loans and moving on to either traditional forms of financing or purchasing a new car. In periods where there's limited availability of credit to consumers, we tend to see lower levels of prepayments and that's what we're currently seeing now.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Okay, but that's driving a lot of forecast revisions. I mean, look, I've covered the company for a long time. There have been periods in which there's been absolutely no credit availability, right? And to consumers, even much worse than right now. How does that compare historically to those periods?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

I would say we're near historical lows there currently. So, we have seen similar low periods, but this is one of the lower periods that we've seen. Our forecast uses more of a historical average of what we've seen with prepayments, and we've seen that come down, which pushes our cash flows out into the future, which lowers the yield that we'll realize on the loans.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Okay. Thank you.

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

I would just add that forecasting the timing of cash flows is challenging since it's dependent on the competitive environment and no one can really forecast how a competitive environment is going to behave in the future. So, it is challenging. I think we take our best crack at it, but it's tough.

John Rowan *Janney Montgomery Scott LLC - Analyst*

But actually, let me ask you another question. So, if people aren't refinancing their cars, why is that? Is that a function of used car prices that they're sitting on a negative equity position, and they don't want to refinance the car and owe some money? Or what is driving that lower level of refinancing activity?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Yeah, I think that certainly could be a factor. I think just the general availability of credit to the consumer is also a factor, but I think the factors you mentioned are contributing factors.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Alright. Thank you.

Operator

Our next question comes from John Hecht with Jefferies.

John Hecht *Jefferies - Analyst*

Apologize for the technical issue earlier. I just have follow up questions for both of the preceding questions. I know this cycle is unique, but in historical cycles where your capital was scarce and maybe there was disruption in the environment, those tended to be favorable environments for you. As an example, thinking about post the great financial crisis. This one continues to be challenged.

I guess the question is, what do you guys think has to happen to clear the market out to the point where it isn't an opportunistic environment for you? Is it simply just work through the '22 vintage? Do residual prices need to come down further? Or what other factors might we look out for?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

I think it's primarily continuing to adjust our loan forecast when we're originating new loans to consider the performance we've seen. And that's what we've continued to do. I mentioned earlier the '22 loans have a less significant impact on our financial statements going forward. Our results should be more based on how our '23 and '24 business performs and, going into next year, how our '25 business performs. As Ken mentioned, we know that forecasting collection rates is difficult so we have a business model designed to produce acceptable returns in aggregate, even if loan performance is worse than forecasted. So, we'll continue to take that approach as we move forward.

John Hecht *Jefferies - Analyst*

Okay, thanks.

Operator

Our next question comes from the line of Robert Wildhack with Autonomous Research.

Robert Wildhack *Autonomous Research - Analyst*

Question on the '23 and '24 vintages specifically. In the second quarter earnings call, I think you mentioned that you expected '23 and '24 to behave similarly to '22. As it stands today though, forecasted collections are 4 percentage points and 6 percentage points higher for '23 and '24, respectively, versus '22. How should we square that difference? Do you think there's another shoe to drop with respect to '23 and '24? And if so, when do you think that could happen?

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Yeah, I think it's difficult to look at just the absolute collection rate because we've originated different mixes of business during those years. I think what you need to look at is our variance to our initial forecast, and you'll see that's currently lower on the '23 and '24 loans. Part of that is due to us having lowered our initial estimates on the '23 and '24 loans when we have originated them because we had started to see some underperformance on the '21 to '22 loans, so we considered that. And then we're also looking at the trends of what '23 has done so far versus '22, and we know those loans are performing better. Based on those two factors, we believe that the '23 business and the '24 business will perform better than the '22 business, but I would also point out, especially the '24 business, is not very seasoned at this point.

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

Yeah, and I would just add that we said in prior calls that we were observing a similar trend in underperformance on the '23 and '24 loans, though that trend was less severe than the '22 loans. So, we're seeing a similar pattern but less severe. And then to Jay's point, we've adjusted our forecast. Our forecast on '23 and '24 was more conservative than '21 and '22.

Robert Wildhack *Autonomous Research - Analyst*

How do the recent hurricanes impact forecasted collections, if at all?

Kenneth Booth *Credit Acceptance Corp - President, Chief Executive Officer, Director*

The hurricanes impacted mainly Florida and North Carolina, Those two states are about 4.2% and 1.5% of our portfolio, but obviously, the hurricanes didn't impact the entire states. Overall, they're really not having that material of an impact to our portfolio. That said, they've been incredibly impactful for the people in the direct path so, consistent with our approach for many years, = we're working to get those impacted by the hurricanes in ways to help them get back on their feet.

Robert Wildhack *Autonomous Research - Analyst*

Okay. If I could just sneak one more in and ask Ken about something you highlighted earlier, specifically that the '22 vintage would still generate Economic Profit. I was wondering if you could give some more context there, like how much more Economic Profit does a good vintage like, say 2019, generate versus 2022?

Kenneth Booth *Credit Acceptance Corp - President, Chief Executive Officer, Director*

We've got a wide variance in Economic Profit. Obviously, 2019 was buoyed by stimulus payments, and it over collected. I don't really want to get into the details of our kind of profitability by vintage. I guess what I would say is 2019 was a highly profitable vintage and 2022 is a lesser profitable one, but they all produce Economic Profit, which means they're all profitable vintages.

Robert Wildhack *Autonomous Research - Analyst*

Okay. Thank you.

Operator

(Operator Instructions) Our next question comes from the line of Ryan Shelley with Bank of America.

Ryan Shelley *Bank of America - Analyst*

Quick question here. So, the active dealer count has come down a few quarters now. Can you just touch on what's driving that? Is that like a function of the softer market? Or being more selective? Just any color there would be great.

Kenneth Booth *Credit Acceptance Corp - President, Chief Executive Officer, Director*

I think active dealer counts were fairly flat to be honest. It was higher in the first quarter due to seasonality. I would say, in terms of the competitive environment, for a while it seemed like a lot of people were pulling back.

It seems like that subsided somewhat and maybe the competitive environment is returning more to a normal environment. However, that being said, we've still been able to grow our market share and are on pace for our highest volume year ever. I feel good about where we're at in terms of the competitive environment and how we're able to grow the business.

Ryan Shelley *Bank of America - Analyst*

Got it. And then just one more quickly if I could. So, you have a bond maturity in March 2026, but it's callable at par now. How should investors think about your thought process around addressing that? Thanks.

Jeff Soutar *Credit Acceptance Corp - Vice President and Assistant Treasurer*

Right. Yeah, we're watching market conditions there very closely. Two good facts with that bond tranche. First, we have plenty of time. It doesn't mature until March of 2026, so we have a year and a half to do something. The other good fact there is it's relatively small at $400 million, so it's small relative to the size of our balance sheet and our liquidity. So, we have plenty of options. We can refinance it in the senior note market, we can refinance it using a securitization, or we can just draw on our existing liquidity. Rates for a new bond issue would probably be higher than the coupon that's on those notes today. So, we're not in a rush to do anything with it. We'll continue to monitor it and do something appropriate before the maturity.

Ryan Shelley *Bank of America - Analyst*

Understood. Thank you.

Operator

Our next question comes from the line of John Rowan with Janney Montgomery Scott.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Just one follow up. The 2022 vintage is now sitting at a 13.2% spread versus an initial of 20.1%. Obviously, it's a relatively big decline, but how do we think about where the level of Economic Profit doesn't become justifiable, right? I mean, 13.2% spread if that's a proxy for the internal rate of return to that pool. I mean or do we just look at that number to go down to your funding costs, or where does that number become uneconomical to you?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

It depends on which program you're talking about. On the purchase program, a 1% decline in the forecasted collection rate, you tax effect that and you have to account for timing, but that ends up driving a reduction in our return. The portfolio program is a little bit more complicated to think about because the shortfall of collections is shared on an 80-20 basis with the dealer up to a certain point. The portfolio program insulates us from variations in consumer loan performance where the purchase program doesn't. So, the purchase program is obviously a lot more sensitive. Our profitability on the purchase program is more sensitive to declines in forecasted collection rates than is the portfolio program.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Okay. Thank you.

Operator

With no further questions in queue, I would like to turn the conference back over to Mr. Martin for any additional or closing remarks.

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

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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