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Q4 2023 Credit Acceptance Corp Earnings Call

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CORPORATE PARTICIPANTS

Douglas W. Busk *Credit Acceptance Corporation - Chief Treasury Officer*
Jay D. Martin *Credit Acceptance Corporation - CFO*
Kenneth S. Booth *Credit Acceptance Corporation - CEO, President & Director*

CONFERENCE CALL PARTICIPANTS

Moshe Ari Orenbuch *TD Cowen, Research Division - MD*
Robert Henry Wildhack *Autonomous Research US LP - US Capital Markets Specialty Financials Analyst*
Vincent Albert Caintic *Stephens Inc., Research Division - MD & Equity Research Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation Fourth Quarter 2023 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 D. Martin ***Credit Acceptance Corporation - CFO***

Thank you. Good afternoon, and welcome to the Credit Acceptance Corporation Fourth Quarter 2023 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 fourth quarter results.

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

Thanks, Jay. Our GAAP and adjusted results for the quarter include:

Adjusted net income of $129 million, which is a 17% decrease from the fourth quarter of 2022.

Adjusted earnings per share of $10.06, which is a 14% decrease from the fourth quarter of 2022.

In terms of collections, we had a decrease in forecasted collection rates that decreased forecasted net cash flows from our loan portfolio by $57 million, or 0.6%, compared to a decrease in forecasted collection rates during the fourth quarter of 2022 that decreased forecasted net cash flows from our loan portfolio by $41 million or 0.5%.

We also had forecasted profitability for consumer loans assigned in 2020 through 2022 that was lower than our estimates at December 31, 2022, due to a decline in forecasted collection rates since the fourth quarter of 2022.

Also, we had slower forecasted net cash flow timing during 2023, primarily as a result of a decrease in consumer loan prepayments to below historical average levels.

From a growth standpoint, unit and dollar volumes grew 26.7% and 21.3%, respectively, as compared to the fourth quarter of 2022. The average balance of our loan portfolio is now the largest it has ever been. On a GAAP and adjusted basis, it increased by 9% and 13%, respectively, as compared to the fourth quarter of 2022.

Our results also included an increase in initial spread on consumer loan assignments to 21.7% compared to 20.9% on consumer loans assigned in the fourth quarter of 2022, and an increase in our average cost of debt, which was primarily due to higher interest rates on recently completed or extended secured financing and the repayment of older secured financings with lower interest rates.

At this time, Doug Busk, our Chief Treasury Officer, Jay Martin, and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Moshe Orenbuch of TD Cowen.

Moshe Ari Orenbuch ***TD Cowen, Research Division - MD***

Great. Gentlemen, if you could just talk a little bit about the competitive environment and how you see it at this stage reflected in the spreads that you're seeing.

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

We feel pretty good about the competitive environment. Volume per dealer is a good metric to reflect the intensity of the environment. It increased, despite the increase in dealer enrollments. New dealers are generally less productive than seasoned dealers. Also our overall growth rate was very high for the quarter and for the 30 days subsequent to year-end.

Moshe Ari Orenbuch ***TD Cowen, Research Division - MD***

I didn't see the January [volume]. Were the January numbers in the release for volumes?

Kenneth S. Booth ***Credit Acceptance Corporation - CEO, President & Director***

Yes. It was 21.5% for the first 30 days.

Moshe Ari Orenbuch ***TD Cowen, Research Division - MD***

At the same time, interest rates have been up a lot. Could you talk a little bit about how the financings you did during Q4 are going to impact interest expense? And is there a way to relate that to the amount of spread that you need to pick up to offset that?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I mean the interest rate in Q4 was 6.3% versus 5.8% in Q3. That obviously doesn't include a full quarter of the $600 million senior note issuance. So all things equal, I expect that number would be even higher going forward. What we try to do when we price our loans is maximize the amount of economic profit, that's economic profit per loan times the number of loans. In doing that, we consider the anticipated expenses we're going to incur over the life of the loan, including interest, sales and marketing, G&A, and salaries and wages. As interest or other expenses go up, we either need to be satisfied with the lower return or reduce our advance rate relative to the anticipated net cash flows.

Moshe Ari Orenbuch ***TD Cowen, Research Division - MD***

Got it. And you did note that there was another kind of write-down for forecast changes in the quarter. Can you talk a little bit about how that will affect the adjusted yield as we go forward?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The adjusted yield declined to 17.9% in Q4 from 18.5% in Q3. What happens in Q1 will be dependent on the yield on new loan originations and loan performance in Q1. All else equal, if nothing else changed, you would expect the decline in forecasted net cash flows in Q4 to put a bit of further pressure on the adjusted yield in Q1. But again, that makes some big assumptions about 'all else equal'.

Moshe Ari Orenbuch ***TD Cowen, Research Division - MD***

Got you. And then just last one for me is, fourth quarter, we don't get the 10-Q. So it looks like you bought back 44,000 shares. Is that math correct? Like is that the right amount?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

I think we bought approximately 100,000 shares back. A little over 100,000.

Operator

(Operator Instructions) Our next question comes from the line of Robert Wildhack of Autonomous Research.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

A question on the forecasted collections, and adjusted yield as well. First, what's behind the continued drop in forecasted collections? Is there anything specific that you'd highlight there? And then do you have any insight or thoughts on when that could ultimately bottom?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The reason for the loan performance being worse than initially expected is a combination of things, including the fact that those loans were originated in a very competitive period, which hurts loan performance. Those consumers financed vehicles at relatively peak valuations. I think the impact of inflation on the consumer has also contributed. It's impossible to say when loan performance will level out. If I look at the 2015 book of business, it leveled out after this point. It still declined, but at a slower rate. Whether that pattern will hold true on the '22 business remains to be seen, but, absolutely at some point, it will level out. It's just difficult to say precisely when.

Robert Henry Wildhack ***Autonomous Research US LP - US Capital Markets Specialty Financials Analyst***

Okay. And then could you speak to the current leverage level and your capacity to both continue buying back shares and also continue growing at this current pace?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

Our leverage on an adjusted basis is within the historical range so we're very comfortable with where we are today. Obviously, our GAAP leverage is different, and it's an apples to oranges comparison of pre-2020 to today's leverage. On a consistently applied basis, our leverage is within the historical norm. The way we think about buybacks is, our first priority is always to make sure that we have the capital that we need to fund anticipated levels of loan originations. So what that means is we're growing faster, all else equal, we buy back less stock. That doesn't mean we don't buy any, but it means we buy back less.

Operator

Our next question comes from the line of Vincent Caintic of Stephens.

Vincent Albert Caintic ***Stephens Inc., Research Division - MD & Equity Research Analyst***

First one, so you highlighted that the average loan balance is as high as it's been and the loan terms have also been increasing. Just wondering if you're comfortable with those ranges, or can you take them higher? And if there are any other adjustments that you are thinking about when you think about underwriting?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

The consumer loan balance was pretty flat on a year-over-year basis. Loan term was up a month. So I don't think there's been a dramatic change over the last couple of years.

Vincent Albert Caintic ***Stephens Inc., Research Division - MD & Equity Research Analyst***

Okay. And then for the forecasted collections. I'm wondering if there's any macro assumptions that are baked into there. For instance, the Manheim Index with used car sales and used car prices, Fed rate cuts, or anything like that. I don't know if that has any influence on your forecasted collections. So if you could talk about that.

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

We don't include macro variables like unemployment rates, inflation rates, or GDP or anything like that. We do have a depreciation curve that we end up using to model forecasted collection rates. So that's factored in, but no one really knows what is going to happen to used vehicle prices over a 60-month loan term. So the way that we deal with uncertainty associated with used car prices and all the other uncertainties is just by building a pretty significant margin of safety into our loan pricing when they are originated. We do that so even if loan performance is worse than expected, our loans are still likely to produce effective levels of profitability.

Vincent Albert Caintic ***Stephens Inc., Research Division - MD & Equity Research Analyst***

Okay. And last one for me. So I understand you have forecasted collections and maybe change underwriting or change some variables to get to your desired results. But when you think about the consumer that you're lending to, do you have any views about how that consumer health is doing? Are trends getting better over the past couple of quarters?

Douglas W. Busk ***Credit Acceptance Corporation - Chief Treasury Officer***

It's pretty early to say. Thus far, the 2023 loans are performing better at the same age than the 2022 loans were, but again, that book of business really isn't all that seasoned. We have made adjustments as we've seen the underperformance of the '21 and '22 loans. We're always making changes to our forecast based on recent trends and loan performance. So we have made adjustments to our forecast there, but I think it's too early to have a conclusive comment on consumer health.

Operator

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

Jay D. Martin ***Credit Acceptance Corporation - CFO***

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.