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Q2 2024 CREDIT ACCEPTANCE CORP EARNINGS CALL

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CORPORATE PARTICIPANTS

- **Jay Martin** *Credit Acceptance Corp - Chief Financial Officer*
- **Kenneth Booth** *Credit Acceptance Corp - President, Chief Executive Officer, Director*
- **Moshe Orenbuch** *TD Cowen - Analyst*
- **Douglas Busk** *Credit Acceptance Corp - Chief Treasury Officer*

CONFERENCE CALL PARTICIPANTS

- **Operator**
- **John Rowan** *Janney Montgomery Scott LLC - Analyst*
- **Rob Wildhack** *Autonomous Research - Analyst*
- **Ryan Shelley** *Bank of America - Analyst*

PRESENTATION

Operator

Good day, everyone, and welcome to the Credit Acceptance Corporation Second Quarter 2024 Earnings Call.

Today's call is being recorded. A webcast and transcript of today's earning call will be made available on Credit Acceptance's website.

At this time, I'd 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 afternoon, and welcome to the Credit Acceptance Corporation Second 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 second quarter results.

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

Thanks, Jay. We had a mixed quarter as it related to collections and originations, two key drivers of our business. Our 2022 vintage continued to underperform our expectations, and our 2023 vintage began to slip as well.

We made an additional $147 million adjustment to forecasted net cash flows on top of our normal loan forecast model to adjust our loans originated in 2022, 2023, and the first half of 2024 to what we believe the ultimate collection rate will be based on trending data over the last several years. Historically, our models have been 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 have had larger than average forecast misses, both high and low, during this volatile period.

Because we understand forecasting collection rates is challenging, our business model is designed to produce acceptable returns, even if loan performance is less than forecasted. Even with our reduction in forecasted collections this quarter, we believe we will continue to produce substantial economic profit per share in the future.

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. We price to maximize economic profit over the long term, and we seek to best position the company if access to capital becomes limited. Ultimately, we are happy we had the discipline to maintain underwriting standards during easy money times in 2021 and especially 2022. While our market share was lower during those years, we believe it has 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 Q2 unit and dollar volume ever, growing our loan unit and dollar volume by 20.9% and 16.3%, respectively. Our loan portfolio is now at a new record high at $8.6 billion on an adjusted basis. Our market share in our core segment continues to increase, being 6.6% as of May 31, 2024.

Beyond these two key drivers, we continued 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. Dealers make incremental sales for the roughly 55% of adults with other than prime credit. So for these adults, that enables them to obtain a vehicle to get to their jobs, take their kids to school, et cetera, but also gives them the opportunity to improve or build their credit.

During the quarter, we originated 100,057 contracts for our dealers and consumers. We collected $1.3 billion overall and paid $84 million in portfolio profit and portfolio profit express to our dealers. We added 1,080 new dealers during the quarter and now have our largest number of active dealers ever for a second quarter with 10,736 active dealers.

From an initiative perspective, we continue to try new go-to-market approaches using a test-and-learn approach. We believe some of these have been successful and have contributed to our growth. We also continued investing in our technology team. We have ramped up personnel and are focusing on modernizing how our teams perform work with the goal of increasing the speed at which we enhance our product for our dealers and consumers.

During the quarter, we received three awards from Fortune, US News, and the Best Practices Institute 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 Make-A-Wish Foundation, St. Jude Children's Research Hospital, the Shades of Pink Foundation, and Versiti Blood Center of Michigan, among others.

Now Doug Busk, our Chief Treasury Officer, Jay, and I will take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Moshe Orenbuch, TD Cowen.

Moshe Orenbuch *TD Cowen - Analyst*

Great, thanks. Is there any way to explain what changes you made in the forecasting methodology? Did you have misses more on the likelihood of default, recoveries on the auto afterwards, or any other practice changes that are involved?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

Well, the first thing is we now believe that the 2022 originations are seasoned enough for us to enhance our estimate over what we provided previously. What we've done, simplistically, is we have assumed that the '23 and '24 originations are going to exhibit similar trends in terms of variance from the initial forecast in the slope of the collection curve, which we plotted out over time.

We're assuming that those percentage changes are going to be similar to what we've seen in 2022. Both trends that we're seeing in '23 and '24 are there, but they're less severe than the '22 loans. Since both books of business are also performing better from an absolute perspective, the adjustment in percentage terms is less significant than the miss we're going to have on the '22 business. So it was really just assuming that the '23 and '24 originations will behave similarly on a percentage basis to what we've seen on '22.

Moshe Orenbuch *TD Cowen - Analyst*

One of the things that's unique about the way you report your adjusted earnings is you take that hit into your provision this quarter, but you spread out the impact on future periods [in your adjusted results]. You had a 19.6% adjusted revenue yield. Can you give us some way of thinking about how much of this is going to flow through and over what period, and how to think about the impact on that 19.6%?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

Well, I think just the yield on the loan asset was 17.7% for the quarter. I think revenue as a percent of average capital was 19.6%. So two slightly different things, but they'll behave similarly. All else equal, if loan performance is exactly as expected, we would expect the yield or revenue, if you want to look at it as a percent of average capital, to decline in Q3.

The magnitude of the decline will obviously be dependent on the yield on new originations. And obviously whether loan performance is better or worse than expected. But all else equal, we would expect revenue or the yield on the portfolio to decline.

Moshe Orenbuch *TD Cowen - Analyst*

And last one for me, and honestly I'm struggling as to how to phrase this, but given that this is the second of these in basically a year, why is it a good thing that you're originating more loans? In other words, shouldn't you be doing the opposite? Shouldn't you be pulling back and saying maybe we're doing something wrong here?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

So it's a fair question. As Ken said in his intro, we still believe that these loans are producing returns in excess of our weighted average cost of capital. That's generally higher than the returns you’re going to see from others in the industry. So we think it's adding shareholder value to continue to originate the business that we're originating. As I said, we feel better about the '23 and '24 loans than we do about the '22 loans, which were obviously very disappointing to us.

Operator

(Operator Instructions) John Rowan, Janney Montgomery Scott.

John Rowan *Janney Montgomery Scott LLC - Analyst*

I'm going to ask Moshe's question, but a little differently. The implied spreads are still pretty high. The initial implied spreads for 2024 are still high, historically speaking. What gives you confidence that those are the right numbers, given the magnitude of the reductions that you're putting into prior forecast revisions? And I guess just trying to figure out if there's more risk of continuing to write the portfolio down if we're aggressive on some of the assumptions going in that are again still writing to relatively high spreads, historically speaking.

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

As I said, we're basing our current estimate for '23 and '24 based on the absolute performance to date of those vintages, and then we're applying a similar degradation in the collection rate over time to what we've seen on '22. Now we're using history as our guide there. Forecasting consumer loans, especially in recent years, has been challenging so we're putting our best number on it, but is there a chance we could be wrong? There's always a chance.

John Rowan *Janney Montgomery Scott LLC - Analyst*

Okay. And then just for modelling purposes, obviously, with the GAAP loss in the quarter, I assume the share count that you reported was the basic share count. Can you give me an idea of what the real diluted share count would be or how many diluted shares you have? So going forward, we will get that in the model.

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

Yeah, I think if you look at our 10-Q in the earnings per share footnote, it will show you how many shares were anti-dilutive for the quarter. That is the case. Since it was a loss, we need to stick with the basic shares. Taking a quick look here to see what was excluded as anti-dilutive... looks like it was around, for the quarter, 217,000 shares.

Operator

(Operator Instructions) Rob Wildhack, Autonomous Research.

Rob Wildhack *Autonomous Research - Analyst*

One more on the '23 vintage. Some other lenders have talked about the early part of that year, maybe in the first quarter of 2023, loans originated then are driving underperformance for that vintage. Would you echo that? Or is the underperformance that you're seeing in 2023 pretty broad based across originations throughout the year?

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

No, I would say that that's a fair comment. We see a situation where the early '21 loans performed better than the last half of '21. The first part of '22 was kind of the bottom from a performance perspective. Things got somewhat better at the end of '22, got better the first part of '23, but the performance of the second half of '23 loans was better than the first half for sure. That trend has continued into 2024, so long-winded answer, I would agree with your commentary.

Rob Wildhack *Autonomous Research - Analyst*

Okay, thanks. And then just on the unit growth, I think April was slower than the quarter was in aggregate, which would imply a step-up in growth in May and June. Is there anything specific that was driving the acceleration in May and June? And then to ask the question kind of forward-looking July, looks pretty strong at plus-28%. Anything to call out there? Is July benefiting from an easy compare or anything like that? Or do you think you can continue to grow at that pace going forward?

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

It is always difficult to predict as there's a lot of macro uncertainties, that come from the competitive environment, inflation, interest rates, and things like that. You are right that it improved throughout the quarter and into July. Whether that continues or not, it's really tough to say. We will have tougher comparables going forward.

So that being said, we have made improvements to our product and we're hoping that that has made a difference as well. And we believe that is a positive impact. So you look at volume per dealer, it’s up, so that's a good sign for us. And that means our product is probably better, and it means our competitive environment is better, and hopefully that continues.

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

I think the other point I would add to what Ken said is it's hard to draw any conclusion from looking at one month at a time. If I look at the growth rates for the quarter, April was 17%, May was 26%, June was 20%, and then July is back up running at 27%. So when you break it down into smaller units, you obviously get more variability.

Operator

(Operator Instructions) Ryan Shelley, Bank of America.

Ryan Shelley *Bank of America - Analyst*

Hey, guys. Quick question here. So along with the earnings, you filed amendments to both the revolving credit agreement and one of the warehouse agreements around the definition of consolidated net income. Can you just explain the rationale there and what that definition change is all about? Thanks.

Douglas Busk *Credit Acceptance Corp - Chief Treasury Officer*

I mean, as we've said for years in our press releases, we think the best way to evaluate our financial performance is on the basis of level yield accounting based on forecasted cash flows. We're looking at the forecasted amount and timing of net cash flows and discounting it back and that gives you a yield. We're using that yield for revenue recognition, and then, every month you re-forecast the loans. If your forecast goes up or down, you adjust your forecast prospectively. The adjustments that we made to the definitions in those credit facilities, basically start with GAAP net income, back out the provision for credit losses, and then apply the floating yield adjustment. When you do that, you get to level yield revenue recognition based on forecasted cash flows.

Operator

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

Jay Martin *Credit Acceptance Corp - Chief Financial Officer*

We'd 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

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Operator

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

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