- Guaranteed auto finance can be great -

Presentation on the ValueX

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Summary

Credit Acceptance Corp. (CACC) is a subprime auto finance company. It has a unique business model, many elements of a "great" business and is too cheap.

Name	Credit Acceptance Corp. (CACC)
Stock price on 2.2.2015	$160.83
Mcap	$3,330 Mio.
+Debt	$1,750 Mio.
=TEV	$5,080 Mio.
P/E (LTM)	13x
TEV/EBIT	11x
Debt/Equity	2.5 : 1

All directors and manager together hold c. 24%; Insider hold additional 50.8% of shares.

Details

How do they make money?

Youtube „The Don Foss Story“

Deal example

The dealer makes a smaller profit initially, but will receive a back end portion of the any profit. This creates an "equity partnership".

Direct sale:

Sales price:	*$10.000*
Purchase price:	*$6.200*
Profit Margin:	*60%*

CACC Financing:

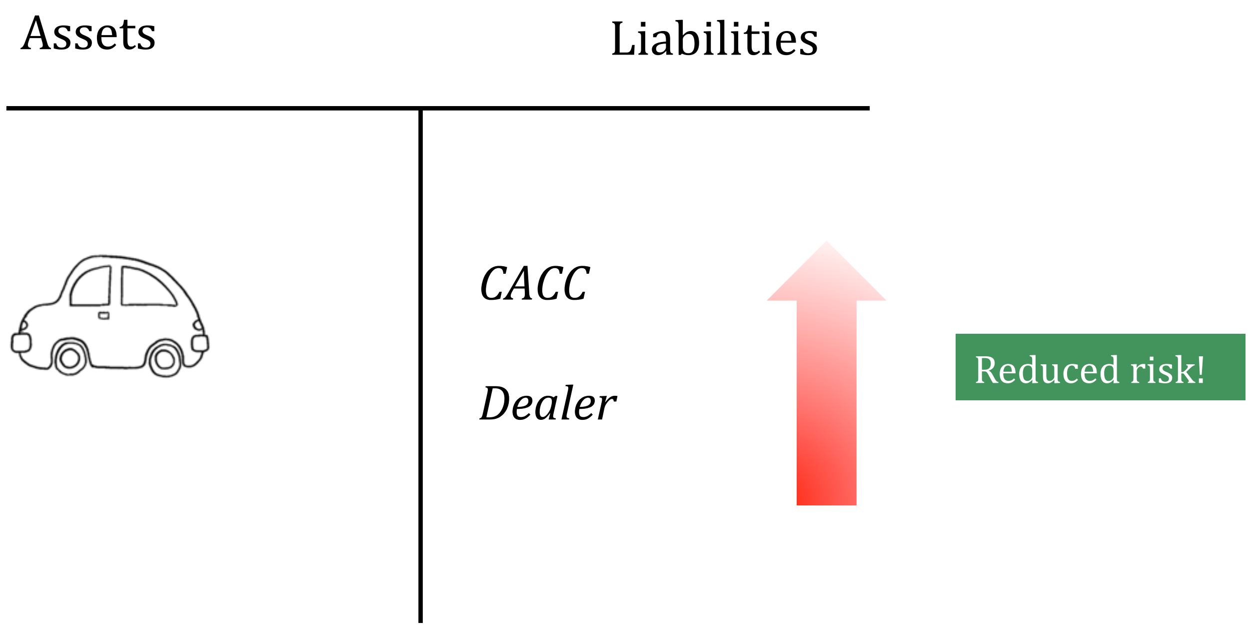
„Down payment"	*$1.700*
„CACC Advance"	*$5.700*
Upfront:	*$7.400*
Profit Margin:	*c.12%*

PLUS 80/20 participation on amount that CACC receives over and above the „advance" and costs.

>>> Strong motivation to care about credit quality and affordibility

An elegant business model

CACC's claim is more senior.



>>> Hard to replicate because dealers won't trust a new player.

Historic results

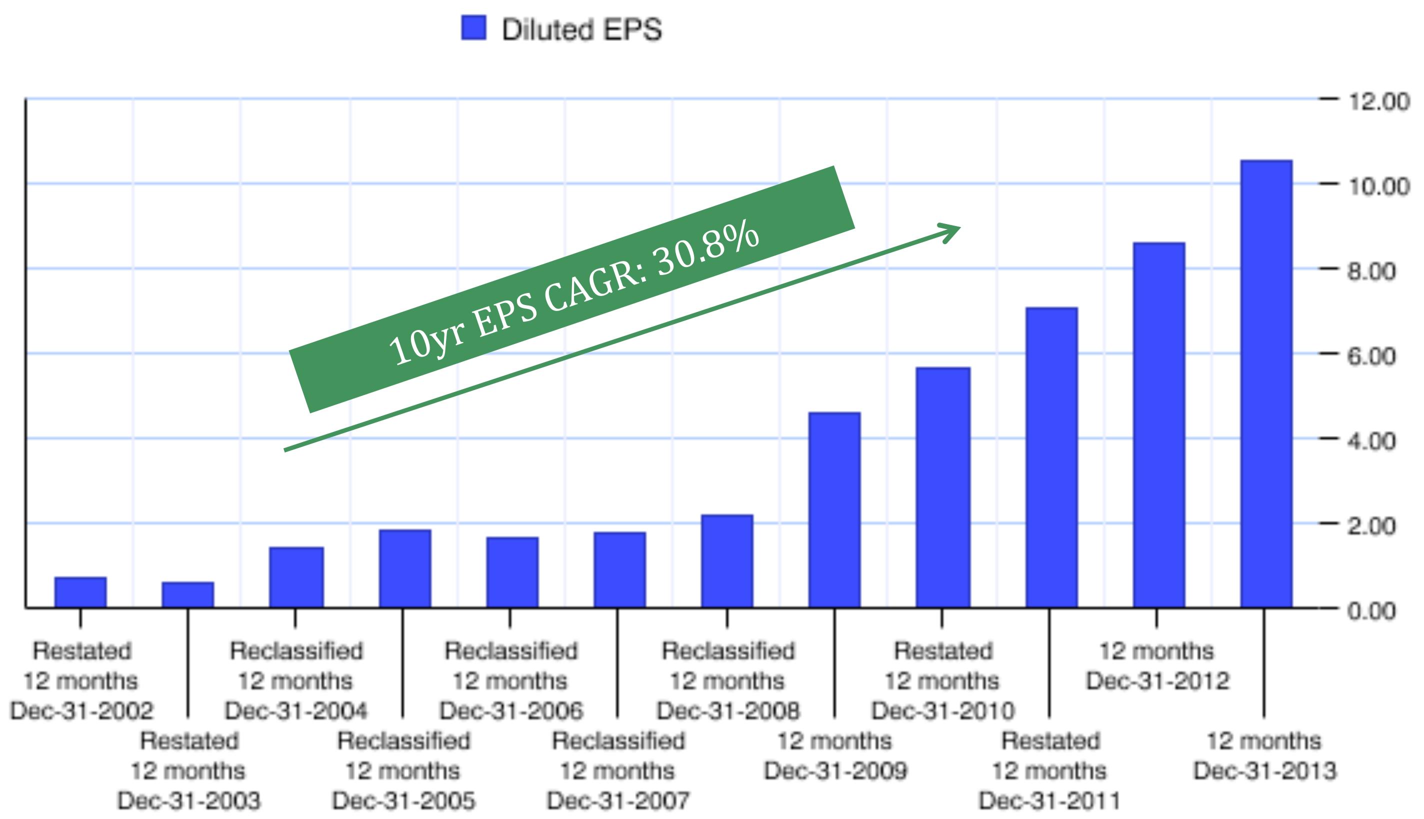
CACC is pretty good in managing credit risk.

	December 31, 2013 forecast	Initial forecast	Variance
2001	67.3 %	70.4 %	-3.1 %
2002	70.4 %	67.9 %	2.5 %
2003	73.7 %	72.0 %	1.7 %
2004	73.0 %	73.0 %	0.0 %
2005	73.7 %	74.0 %	-0.3 %
2006	70.0 %	71.4 %	-1.4 %
2007	67.9 %	70.7 %	-2.8 %
2008	70.1 %	69.7 %	0.4 %
2009	79.2 %	71.9 %	7.3 %
2010	77.0 %	73.6 %	3.4 %
2011	74.1 %	72.5 %	1.6 %
2012	73.5 %	71.4 %	2.1 %
2013	73.3 %	72.0 %	1.3 %
Average[1]	73.1 %	71.8 %	1.3 %

[1] Calculated using a weighted average based on loan origination dollars.

>>> Over the last 13 years only 3 years with negative variance!

EPS history



Quelle: Capital IQ

>>> CACC did not have a single year with a loss

Elements of a great business

Barriers to entry – B2E

In auto finance there are no B2E. But CACC managed to develop itself into a resilient business that works over different competitive and business cycles.

Demand side/Car dealer

- [x] Search costs
- [ ] Habit
- [x] Switch cost

Supply side/CACC

- [ ] Protected technology
- [x] Learning curve
- [ ] Location / Access to resources
- [ ] Economies of scale
- [ ] Network Effect

>>> Hard to replicate – abnormal returns likely

Management – CEO is an „outsider“

Management is paid based on EVA[1]. [Brilliantly explained in 10K]

($ in millions)

	Adjusted average capital invested	Adjusted return on capital	Adjusted weighted average cost of capital	Spread
2001	$ 469.9	7.4%	8.4%	-1.0%
2002	$ 462.0	7.7%	8.9%	-1.2%
2003	$ 437.5	6.6%	9.0%	-2.4%
2004	$ 483.7	13.1%	8.6%	4.5%
2005	$ 523.4	14.7%	8.3%	6.4%
2006	$ 548.5	12.9%	8.1%	4.8%
2007	$ 710.1	12.1%	7.0%	5.1%
2008	$ 975.0	11.2%	6.4%	4.8%
2009	$ 998.7	14.9%	6.7%	8.2%
2010	$ 1,074.2	18.7%	7.2%	11.5%
2011	$ 1,371.1	16.9%	6.4%	10.5%
2012	$ 1,742.8	14.9%	5.5%	9.4%
2013	$ 2,049.2	14.2%	5.7%	8.5%
Compound annual growth rate 2001 – 2013	13.1%			

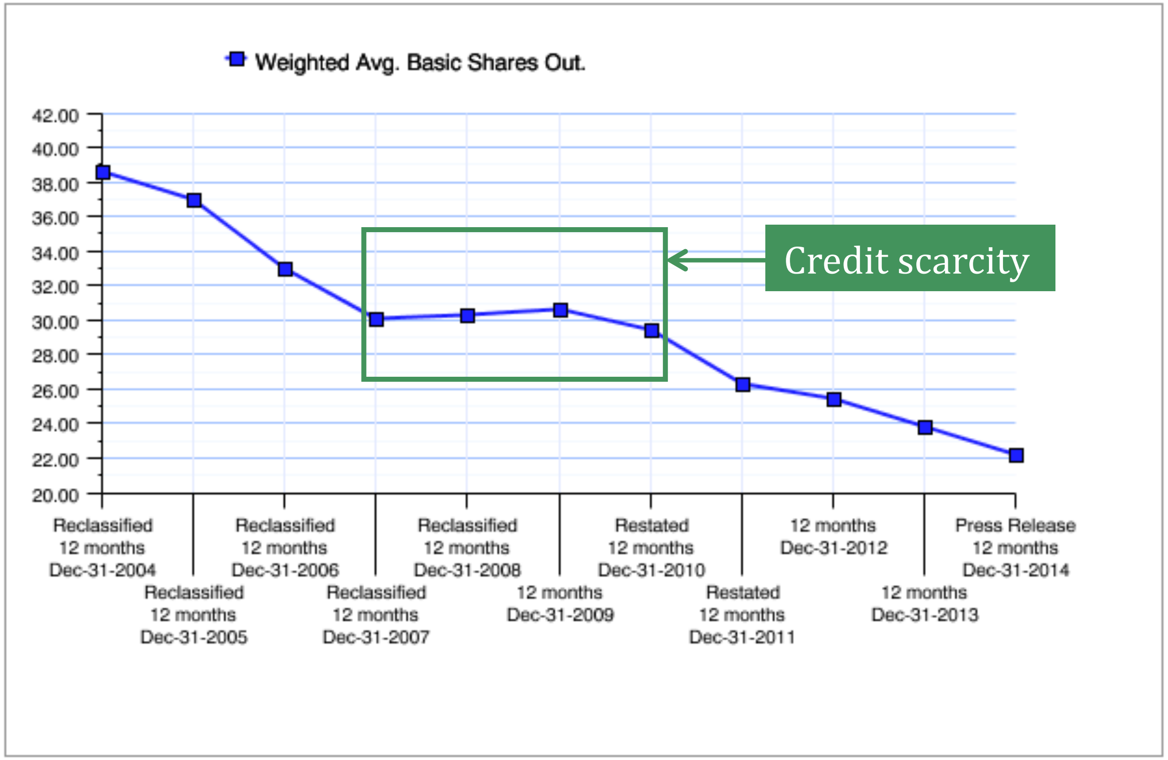
Higher Spread

More invested capital

[1]EVA = Economic Value Add: Invested Capital x (ROIC – Cost of Capital)

Stock repurchases

Die company is a cannibal. On average it eats itself by more than 4% per annum



Quelle: Capital IQ

>>> Great board will likely ensure great capital allocation

Focus: „Be the best in the world at ...“

Firm has a clear understanding about its core competence. (Reference: “Good to Great”, Jim Collins).

„Our core product has remained essentially unchanged for 41 years. We provide auto loans to consumers regardless of their credit history.“

„Today, we offer one product and focus 100% of our energy and capital on perfecting this product and providing it profitably.“

>>> Advantage on learning curve

Growth

In a tough competitive environment, CACC concentrates on signing up new dealers accepting a lower number of deals per dealer.

	Growth active dealer	Growth volume per dealer	Growth credit volume
2005	45.1%	-24.5%	9.6%
2006	25.9%	-10.6%	12.5%
2007	27.7%	-8.7%	16.6%
2008	15.5%	-1.3%	13.9%
2009	-2.9%	-5.9%	-8.7%
2010	1.2%	22.0%	23.5%
2011	24.7%	4.2%	30.0%
2012	33.0%	-19.8%	6.7%
2013	20.2%	-11.5%	6.4%
CAGR	20.3%		11.8%

Tough comp environment
>>> but 6% growth= bear case?

Growth

However: In Q4 earnings comment:

… during the fourth quarter of 2014 [ ] the number of active dealers grew 14.5% and average volume per active dealer grew 5.0%.

We believe the increase in volume per dealer was the result of decreased competition during the fourth quarter of 2014.

Valuation

Valuation

(Case 1) High competition

Growth of 0% to 6% + Stock repurchase 4%

>>> 4% to 10% EPS growth

(Case 2) Less comp

Volume per dealer will go up

Spread will go up

>>> 15% to 20% EPS growth

ROIC	14%-18%
ROE	36%
Capex	<5% of op. Cash Flow

>>> Current P/E of 13x offers a large margin of safety

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