UCLA Anderson
School of Management

The Finance Company for an All-Weather Portfolio: Credit Acceptance (CACC) – John Bay, CFA

CACC 7 3/8 03/15/23 — Fixed Income Relative Value

101.392/101.781 6.963/6.850 BMRK @ 13:34 | 95) Buy | 96) Sell | 97) Settings

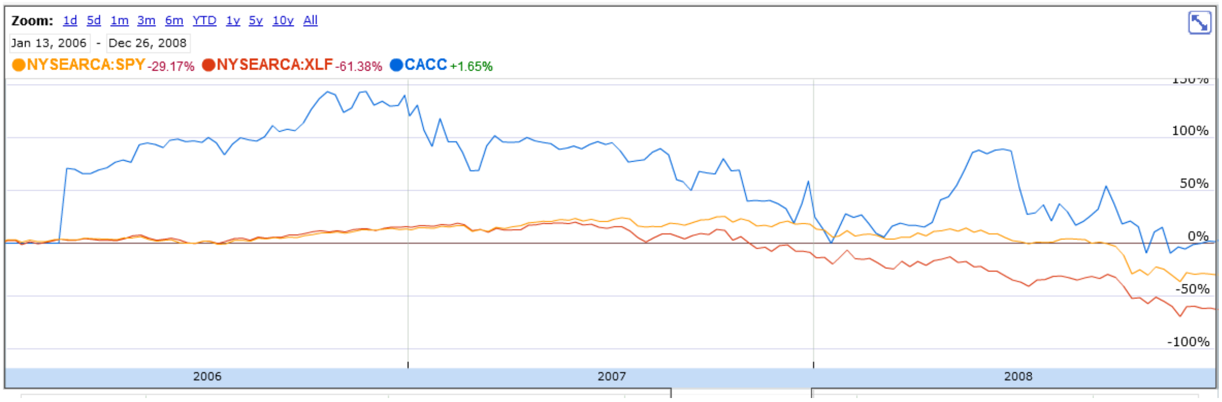
BVAL as of 04/04/2017 - LO 4PM | 10/04/16 - 04/04/17 | 6 Months

	Spread	Low	Range	High	Avg	+/- bps	StdDev	#SDs
1) Spreads to Curves (RV)			◆ Avg ● Now					
2) Spread-Bench	519	434		520	481	38	23	1.7
3) G-Spread	540	455		541	497	43	20	2.2
4) I-Spread	519	438		520	486	33	23	1.4
5) Z-Spread	520	441		522	488	32	23	1.4

Business Description: Credit Acceptance Corporation offers financing programs that enable automobile dealers to sell vehicles to consumers. The Company's financing programs are offered through a network of automobile dealers. The Company has two Dealers financing programs: the Portfolio Program and the Purchase Program. Under the Portfolio Program, the Company advances money to dealers (Dealer Loan) in exchange for the right to service the underlying consumer loans. Under the Purchase Program, the Company buys the consumer loans from the dealers (Purchased Loan) and keeps the amounts collected from the consumer. Dealer Loans and Purchased Loans are collectively referred to as Loans. As of December 31, 2016, the Company's target market included approximately 60,000 independent and franchised automobile dealers in the United States. The Company has market area managers located throughout the United States that market its programs to dealers, enroll new dealers and support active dealers.

Investment Thesis: About a month ago our Student Investment Fund class at UCLA Anderson did a company visit to one of the best-performing asset managers in the world, Mohnish Pabrai, of Pabrai Investments. In Mohnish's laid back, Southern California office, one of our classmates was bold enough to question Mohnish' large bet on the US auto industry. What followed was an hour long schooling that, short of making us look foolish (most of us were doubtful about the bet), would change the way we all considered the auto industry. Leaving out the bits about cars, what was really the most fascinating part was Mohnish' conviction in the "captive finance arms" as he called them, of the big auto companies. In his view, even though US car companies trade at mid-single digit Price-Earnings multiples right now, the CFA's deserve to trade at 15-20x multiples. These companies, he assured us, were built to withstand any economic downturn. The reason for this was far from obvious, and I can guarantee that not a single one of us had considered it. But here is the rationale: auto-loans, in general, are much "safer" investments than something like a mortgage-backed security. The reason is because (this is my own reasoning, after I'd researched it), almost every state will favor the tenant in the event of a home foreclosure. And not only that, but banks who originated the loans don't want the property to be abandoned, since it reduces the value of the home. Folks who are in foreclosure are not likely to be kicked off their property, and so, in a nutshell, there is a much greater incentive for a distressed family to default on a home loan than on an auto loan. Auto loans, by contrast, don't carry the same bias towards the consumer. Cars, in general, can be repossessed almost immediately after payments cease to be made. Some of the newer model cars, I've heard, can even be remotely turned off by the title-holder finance company. In short, car-owners don't enjoy the same protections as homeowners, and thus car-owners keep making their payments. Let's not also forget the economic reason for owning a car: getting to and from work. People need their cars to commute, they can sleep in their cars, they can't commute in their beds. Another thing about these CFA's, they are not subject to the same vagaries as the earnings of auto companies. Car companies' earnings are driven by auto sales in the current year. The finance arms of the car companies, however, smooth the earnings from the loans made in any one year over the life of a loan (which is often 4 to 6 years.) Therefore, only one sixth or less of the CFA's earnings in any one year are subject to the whim of auto sales. This makes for an extremely resilient business model.

As Mohnish spoke, something occurred to me: why not simply invest in one of these "Captive Finance Arms" of a car company, did any of them exist as standalone companies? Unfortunately not, he said with a chuckle, after all, that's why they're captive. The rest of our meeting went on, and Mohnish continued to impress us with his market commentary. But I remained unconvinced that a captive finance arm did not exist by itself. After weeks of searching through tens of thousands of names on every major exchange around the world, my search has finally borne fruit. That fruit is Credit Acceptance (CACC.) Credit Acceptance has been around since the 1970's, and its business model is to extend credit to low-FICO score borrowers (95% of customers have a score of 650 or below, including some with no credit history). Before you go running for the hills, don't worry, I looked at how they performed through the financial crisis. How CACC performed was almost exactly how Mohnish said they would. From the first day in 2006, to the first day in 2009, CACC's common stock absolutely crushed both the S&P 500 and the XLF (finance ETF) in terms of absolute stock performance, returning positive 1.65% when XLF was down 61% and the general market was down 29%.



When I drilled down into the financials of '08 and '09, I discovered that, far short of decreasing net income, CACC's results only improved (not the case for most of the big banks, and we all know how many of the auto makers performed). I discovered that the source of their competitive advantage was their dynamic risk-readjustment strategy implicit within their scorecard methodology. The moment CACC takes over a loan, or originates one, they start collecting data, and are able to use their massive amount of past consumer loan data to make educated guesses on which loans are going to default, and which are not, as a loan seasons. Due to the amount of loans that they service, they are perhaps better at this than anybody else in the world, if we consider that the captive finance arms of major car companies are not extending loans to "bad" credit quality end-customers.

CACC's conservative underwriting, and loss assumptions, meant that their net income (which forecast some default rate) was too low, and reverted strongly back up when charge-offs were significantly lower than imagined.

	Forecasted Collection Percentage as of (1)				Current Forecast Variance from		
Consumer Loan Assignment Year	December 31, 2016	December 31, 2015	December 31, 2014	Initial Forecast	December 31, 2015	December 31, 2014	Initial Forecast
2007	68.2%	68.1%	68.0%	70.7%	0.1 %	0.2 %	-2.5 %
2008	70.4%	70.3%	70.3%	69.7%	0.1 %	0.1 %	0.7 %
2009	79.4%	79.4%	79.4%	71.9%	0.0 %	0.0 %	7.5 %
2010	77.6%	77.4%	77.2%	73.6%	0.2 %	0.4 %	4.0 %
2011	74.7%	74.2%	74.0%	72.5%	0.5 %	0.7 %	2.2 %
2012	73.7%	73.2%	73.4%	71.4%	0.5 %	0.3 %	2.3 %
2013	73.4%	73.4%	73.7%	72.0%	0.0 %	-0.3 %	1.4 %
2014	71.8%	72.6%	72.6%	71.8%	-0.8 %	-0.8 %	0.0 %
2015	66.1%	67.8%	—	67.7%	-1.7 %	—	-1.6 %
2016	65.1%	—	—	65.4%	—	—	-0.3 %

To give an example of the power of their business model, in only 3 of the last 10 years did their initial forecast of collections exceed the actual collection rate, in '07, '15, and '16 (with '16 essentially being flat.) These years of "underperformance" were followed by strong years of outperformance. We can see that in '09/'10 the forecast variance strongly recovered to 7.5% and 4% respectively. I believe that this result highlights a fundamental misunderstanding by the market of the degree to which folks need their cars, and will continue to make auto loan payments. Only in the depths of '07 did the actual collections rate dip below 70%, and in '08/'09 when the market was still anemic, unemployment was still high, and housing prices were still very low, collections surged back to the high seventies.

	2016	2015	$ Change	% Change
Revenue:				
Finance charges	$ 874.3	$ 730.5	$ 143.8	19.7 %
Premiums earned	43.0	48.2	(5.2)	-10.8 %
Other income	51.9	46.6	5.3	11.4 %
Total revenue	969.2	825.3	143.9	17.4 %
Costs and expenses:				
Salaries and wages (1)	126.5	116.4	10.1	8.7 %
General and administrative (1)	48.2	37.8	10.4	27.5 %
Sales and marketing (1)	49.4	45.9	3.5	7.6 %
Provision for credit losses	90.2	41.5	48.7	117.3 %
Interest	97.7	76.0	21.7	28.6 %
Provision for claims	26.0	33.2	(7.2)	-21.7 %
Total costs and expenses	438.0	350.8	87.2	24.9 %
Income before provision for income taxes	531.2	474.5	56.7	11.9 %
Provision for income taxes	198.4	174.8	23.6	13.5 %
Net income	$ 332.8	$ 299.7	$ 33.1	11.0 %

Above is a snapshot of CACC's most recent income statement. The numbers tend to speak for themselves, but the business is very high margin, with little to no overhead, and the lion's share of expenses are highly variable, and therefore able to be adjusted in tight squeezes. It is also worth mentioning that CACC's operating strategy builds in a robust margin of safety, based on their highly selective geographic expansion strategy. CACC has found, over time, that it is worth being very selective about what customers they take on, and which they do not. This is their most sacred principle. Rather than go full-bore into a partner dealership and try to drum up every low-credit score loan, they will only take those that score well in their proprietary model. Once a specific dealership does not have any more of those, they will consider expanding to a new dealership. This selectivity has ensured they don't saturate any market.

CACC	2017 E	2016	2015
Finance charges	$1,011.8	$874.3	$730.5
Premiums earned	$40.8	$43.0	$48.2
Other income	$54.7	$51.9	$46.6
Total revenue	$1,107.2	$969.2	$825.3
Salaries and wages (1)	$153.1	$126.5	$116.4
General and administrative (1)	$54.2	$48.2	$37.8
Sales and marketing (1)	$60.1	$49.4	$45.9
Provision for credit losses	$83.0	$90.2	$41.5
Interest	$109.5	$97.7	$76.0
Provision for claims	$24.1	$26.0	$33.2
Total costs and expenses	$484.1	$438.0	$350.8
Income before provision for income taxes	$623.1	$531.2	$474.5
Provision for income taxes	$231.2	$198.4	$174.8
Net income	$391.9	$332.8	$299.7
EBITDA	$732.6	$644.2	$564.7
Credit Statistics			
EBITDA/ Interest	6.69	6.59	7.43
Debt/ Equity	1.22	2.22	2.17
EV/ EBITDA	8.86	10.73	11.28

Relative Valuation: Above is a brief DCF, showing my own estimates for next year's coverage ratios, as well as those from the prior two years.

Out of the two publicly available issuances of CACC's debt, both are high yield, but only one provides a level of spread that far exceeds its peer group, for what, in my view, remains an acceptable level of risk. As mentioned before, given the less-cyclical nature of CACC's business (i.e., the revenue drivers are loans that are generated across a wide range of years, and thus is less prone to the vagaries of the overall auto cycle, than say, a car company), I would question whether or not CACC should even be considered a high yield credit (rated BB-, stable outlook). Below is a snapshot of the DDIS (debt distribution screen in Bloomberg. The relevant bond matures in 2023:

While it's clear that the market is pricing in some negativity for CACC going forward (see the recent Morgan Stanley article regarding the froth in subprime auto lending), it is not immediately obvious that CACC will be the one to falter. Shortly after the negative research report came out from Morgan Stanley, predicting a 50% fall in the prices of used cars over the next 5-10 years, another, more nuanced report came out from Eaton Vance regarding an analyst's view of why the fears of subprime are overdone. But nonetheless, recent weakness in the trading of CACC vs the market may provide an attractive entry point for a patient investor:

The chart below does an accurate job of portraying CACC's excess spread versus its appropriate peer group.

Avg of Comparables		6.03	383	137	36	144	102	35	1.0
11) CNGHLD 9 3/8 05/20	91.36	12.82	1106	-586	-774	-573	-667	81	1.1
12) ENVA 9 3/4 06/21	101.85	9.05	728	-208	-636	-192	-361	153	1.2
13) JEFFIN 6 7/8 04/22	95.57	7.96	599	-79	-215	-75	-119	40	1.1
14) CACC 7 3/8 03/23	101.05	7.06	520						
15) NSM 6 1/2 07/21	100.89	5.94	441	79	-66	117	38	41	0.8
16) LADCAP 5 7/8 08/21	101.01	5.53	373	147	-146	149	8	139	1.9
17) FLY 6 3/8 10/21	102.69	5.52	370	150	35	195	118	32	0.8
18) DAN 5 3/4 04/25	100.29	5.69	363	157	120	167	150	7	0.5
19) IEP 5 7/8 02/22	101.48	5.30	357	163	-119	163	51	112	1.6
20) AMGFIN 8 1/4 12/20	109.41	5.40	356	164	-149	164	61	103	1.6
21) LPLA 5 3/4 09/25	101.22	5.51	345	175	92	175	131	44	1.6
22) PSEC 5 7/8 03/23	103.20	5.24	319	201	73	204	131	70	2.7
23) NAVI 8 03/20	108.50	4.89	314	206	64	237	149	57	1.1
24) LUK 5 1/2 10/23	106.44	4.23	219	301	173	301	225	76	2.3
25) CIT 5 08/23	104.52	4.18	209	311	221	313	266	45	2.9
26) AYR 7 5/8 04/20	112.21	3.34	158	362	222	365	309	53	1.8
27) DFS 5.2 04/22	108.25	3.41	142	378	282	379	323	55	3.1
28) RBS 6.4 10/19	108.87	2.76	108	412	311	414	350	62	3.4
29) CORTNP 12 02/22	103.89	10.73							

To juxtapose two comparables; in particular, DFS (Discover Financial Services) offers 378 basis points less spread annually, but it has been empirically shown that, under stress, borrowers are far less likely to default on their car loans than they are to default on their credit cards. In fact, due to the ability of a consumer to work out their credit card debt, and/ or open up a new credit card in perhaps another family member's name, credit cards are one of the first things that consumers default on. The Eaton Vance article previously-mentioned asserts that, due to the strength of the ABS vehicle's structure, no ABS based on auto loans has ever actually defaulted.

Another comparable to draw a comparison to is CIT group. In CIT's most recent annual report, earnings were substantially negative (vs. CACC's 32% + margins), debt to equity was at 1.4x (which is similar to what CACC will be next year with its maturing debt), and its free cash flows were only ~ $500MM (similar to CACC's free cash flow of $501MM), however CIT group's 2023 maturing debt has 311 points less spread than CACC's bonds. To me, this reflects a fundamental misunderstanding of the market's assessment of relative risk. CIT operates in a highly competitive banking industry in which margins are being pressured by bulge bracket competitors like BAC, C, JPM, GS, and other regionals like USB and MTB. Meanwhile, CACC's resilient margins paint the story of a quiet oligopolist controlling a small niche of the market that nobody really understands.

CACC US Equity | 96) Actions | 97) Output | 98) Settings | Financial Analysis

ADJ Credit Acceptance Corp | Periods 10 Annuals | Currency USD

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Segments | 7) Addl | 8) ESG | 9) Custom

11) Benchmark | 12) Contractual Obligations | 13) Options | 14) Employee Data | 15) More...

In Millions of USD except Per Share	CY 2011	CY 2012	CY 2013	CY 2014	CY 2015	CY 2016
12 Months Ending	12/30/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/30/2016
Return on Common Equity	37.07	37.82	36.90	36.66	36.77	31.67
Russell 1000 Financial Services Index	7.41	8.05	9.42	8.81	9.47	9.16
Return on Capital	13.94	12.88	12.61	11.58	11.00	9.83
Russell 1000 Financial Services Index	2.09	2.47	3.00	2.91	3.57	3.67
Operating Margin	63.34	62.86	64.53	63.12	63.33	60.95
Russell 1000 Financial Services Index	16.64	17.80	21.52	20.56	21.97	21.23
Price/EPS	11.64	11.85	12.33	10.87	14.99	13.34
Russell 1000 Financial Services Index	12.26	12.65	14.73	16.56	16.29	18.70
Price/Book	3.90	3.94	3.98	4.00	4.64	3.68
Russell 1000 Financial Services Index	0.99	1.16	1.46	1.55	1.50	1.64
Periodic EV to Trailing 12M EBITDA	8.53	8.82	9.17	9.28	11.28	10.73
Russell 1000 Financial Services Index	13.77	15.44	15.59	16.71	14.87	12.69
Net Debt/EBITDA	7.88	7.27	5.50	5.03	4.44	2.51

The statistics above show a strong history of ROE, ROCE, and operating margins. Although we see that there has been some minor decrease in the ROE and ROCE, this is not uncommon, and in fact the same thing happened leading up to the financial crisis. As more "me too" firms came in and attempted to imitate CACC's strategy, a lot of these firms ended up taking on too much credit risk by going more deeply into sub-prime, and were consequently squeezed out of the business after returns ended up faltering. But it is striking to notice that in spite of vastly superior ROE, ROCE, and operating margins, the P/E of CACC's lags the finance industry, and the spread has widened in recent years, while EV/ EBITDA's for CACC have remained low compared to financial services, but have converged in recent years. I believe this highlights the strong growth in EBITDA's of CACC vs the industry, at a time when growth for financial companies had been harder to come by.

CACC US Equity | 96) Actions | 97) Output | 98) Settings | Financial Analysis

ADJ Credit Acceptance Corp | Periods 10 Annuals | Currency USD

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Segments | 7) Addl | 8) ESG | 9) Custom

11) Standardized | 12) As Reported

In Millions of USD except Per Share	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	Last 12M
12 Months Ending	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2016
+ Net Change In Deposits	0.0	0.0	0.0	0.0	0.0	0.0
+ Other Financing Activities	-6.5	-5.3	-30.4	-10.6	-4.7	-4.7
+ Net Cash From Disc Ops	0.0	0.0	0.0	0.0	0.0	0.0
Cash from Financing Activities	96.6	3.1	0.4	235.2	436.6	436.6
Effect of Foreign Exchange Rates	0.0	0.0	0.0	0.0	0.0	0.0
Net Changes in Cash	4.3	-4.8	2.2	-0.1	8.3	8.3
Cash Paid for Taxes	92.4	119.6	99.9	146.9	111.2	111.2
Cash Paid for Interest	56.2	57.5	55.2	61.8	88.0	88.0
Reference Items						
Net Cash Paid for Acquisitions	0.0	0.0	0.0	0.0	0.0	
Tax Benefit from Stock Options	2.0	1.3	13.6	0.3	27.2	27.2
Free Cash Flow	299.8	320.1	360.9	400.2	501.7	501.7
Free Cash Flow to Equity	552.8	461.8	721.2	732.2	1,037.5	1,037.5
Free Cash Flow per Basic Share	11.80	13.42	16.22	19.16	24.68	24.69
Price to Free Cash Flow	8.62	9.69	8.41	11.17	8.81	7.86
Cash Flow to Net Income	1.40	1.29	1.37	1.35	1.52	1.64

The chart above drills home the strong free cash flow growth of the company, increasing 67% in only 4 years. The company also has been hesitant to make any acquisitions, as it prefers to grow organically through its tried and true pattern of making strategic alliances with new dealerships. We can also see that the quality of earnings seems to be improving, as the cash flow to net income ratio continues to expand.

CACC US Equity | 96) Actions | 97) Output | 98) Settings | Financial Analysis

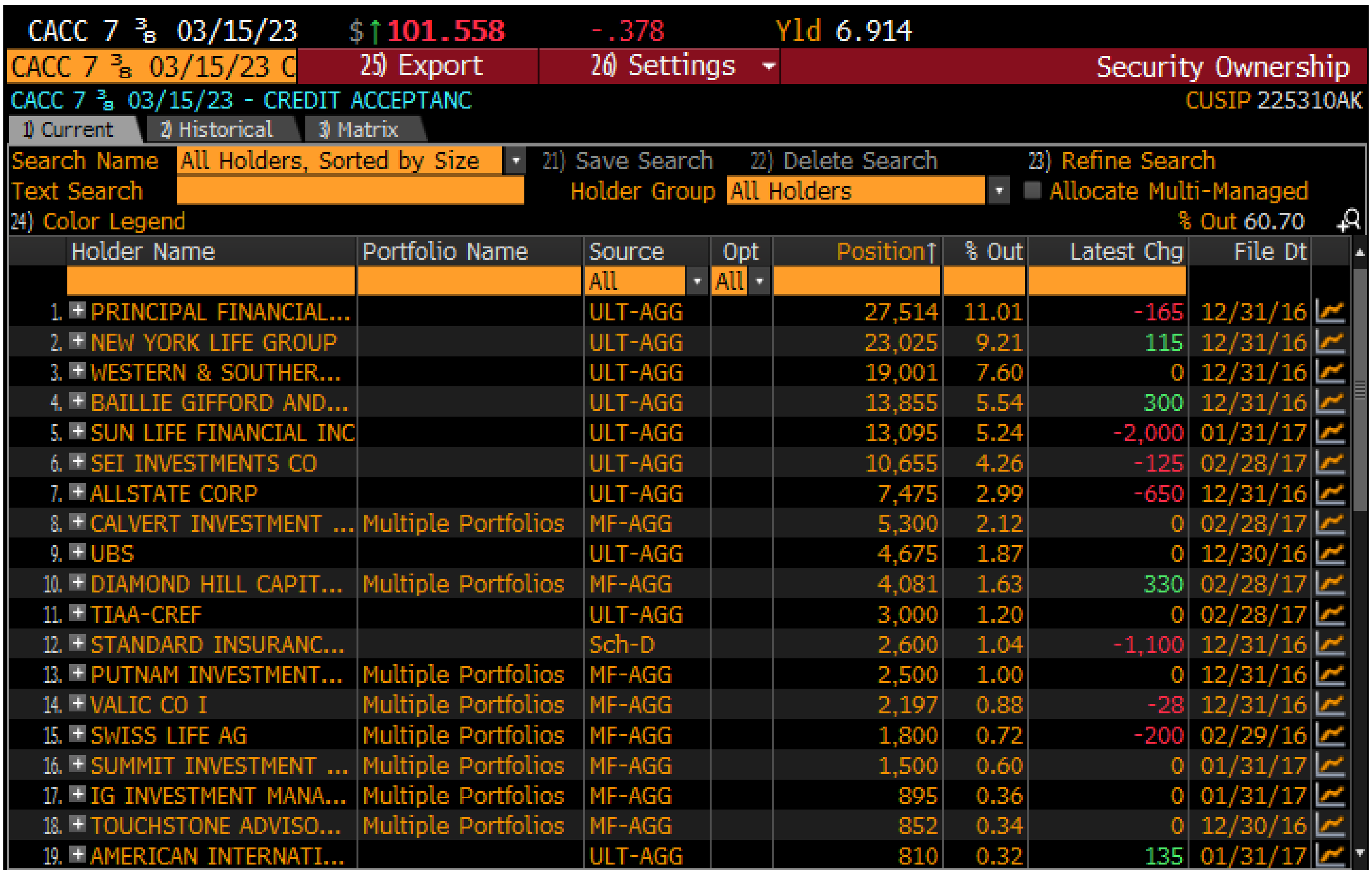
ADJ Credit Acceptance Corp | Periods 10 Annuals | Currency USD

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Segments | 7) Addl | 8) ESG | 9) Custom

11) Profitability | 12) Growth | 13) Credit | 14) Liquidity | 15) Yield Analysis | 16) DuPont Analysis

In Millions of USD except Per Share	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
12 Months Ending	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015	12/31/2016
1 Year Growth						
Revenue	18.79	16.00	11.97	6.07	14.07	17.44
EBITDA	16.45	15.12	13.78	3.02	15.06	14.08
Operating Income	16.93	15.75	16.06	5.70	12.73	11.95
Net Income to Common	10.56	16.83	15.20	5.18	12.58	11.04
EPS Diluted	24.69	21.36	22.84	13.09	19.80	14.22
EPS Diluted before XO	24.69	21.36	22.84	13.09	19.80	14.22
EPS Diluted before Abnormal	24.03	21.36	22.84	19.11	13.74	14.22
Fixed Assets	13.25	20.18	0.45	-6.28	-9.57	-3.70
Total Assets	30.90	21.30	14.07	14.47	21.08	25.07
Employees	20.30	21.89	4.19	-1.06	9.36	12.91
Short-Term Debt	-5.42	191.01	141.01	-2.13	38.22	53.07
Total Debt	45.53	25.35	11.32	25.86	17.99	25.92
Total Equity	13.80	15.18	20.61	-6.39	32.17	26.46
Capital	32.55	21.78	14.41	14.57	22.05	26.09
Book Value per Share	21.26	22.38	26.77	4.27	35.22	28.09

The chart above highlights the growth ratios of many of CACC's statistics. Importantly, the revenue growth remains strong. This is critical since earnings and cash flows will all cascade down from revenues. It is rare to see a company that has grown so rapidly, have revenue decrease so little, but this speaks to the importance of driving to the US consumer (CACC does not do loans outside of the US). EBITDA continues to also grow at a healthy 14% clip YoY, only down two percentage points from 2011, while net income growth has actually increased to 11% from 10.5%. Hiring also remains strong at CACC, coming in at 13% growth in headcount last year, vs 20% in 2011. While short-term debt has increased by 53% this year, that is likely a one-time event aimed at locking in a borrowing cost before rates begin to rise. Total debt growth overall has actually decreased from 45% in 2011 to 26% today, while equity growth has gone from 13% in 2011 to 26% today. While it may seem troubling that operating income has dipped from 2011 to today, CACC has gone through this cycle before, and has emerged much stronger for it.



CACC 7 3/8 03/15/23 $↑101.558 -.378 Yld 6.914

CACC 7 3/8 03/15/23 C | 25) Export | 26) Settings | Security Ownership

CACC 7 3/8 03/15/23 - CREDIT ACCEPTANC CUSIP 225310AK

1) Current 2) Historical 3) Matrix

Search Name: All Holders, Sorted by Size | 21) Save Search | 22) Delete Search | 23) Refine Search

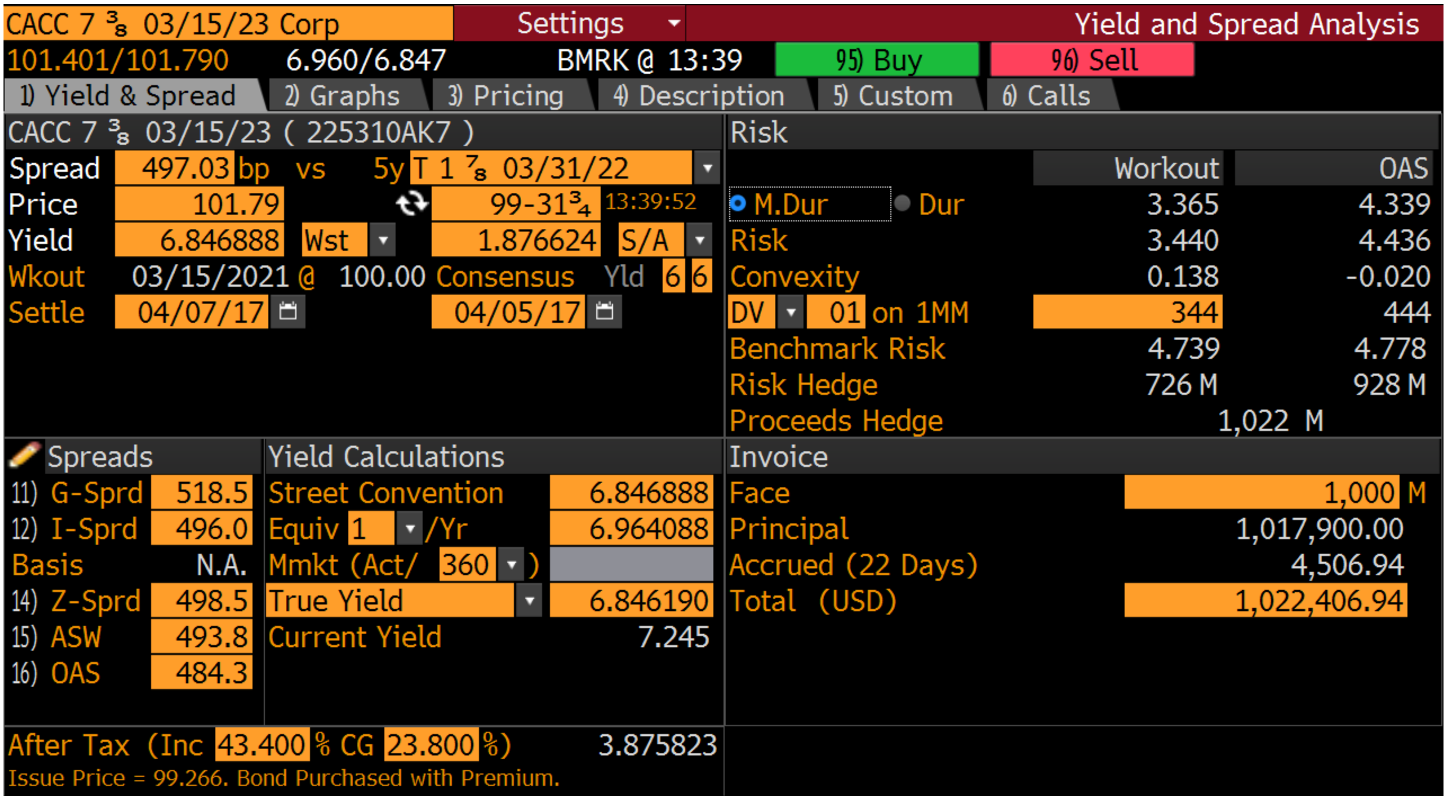
Text Search | Holder Group: All Holders | Allocate Multi-Managed

24) Color Legend | % Out 60.70

	Holder Name	Portfolio Name	Source	Opt	Position↑	% Out	Latest Chg	File Dt
			All	All				
1.	PRINCIPAL FINANCIAL...		ULT-AGG		27,514	11.01	-165	12/31/16
2.	NEW YORK LIFE GROUP		ULT-AGG		23,025	9.21	115	12/31/16
3.	WESTERN & SOUTHER...		ULT-AGG		19,001	7.60	0	12/31/16
4.	BAILLIE GIFFORD AND...		ULT-AGG		13,855	5.54	300	12/31/16
5.	SUN LIFE FINANCIAL INC		ULT-AGG		13,095	5.24	-2,000	01/31/17
6.	SEI INVESTMENTS CO		ULT-AGG		10,655	4.26	-125	02/28/17
7.	ALLSTATE CORP		ULT-AGG		7,475	2.99	-650	12/31/16
8.	CALVERT INVESTMENT ...	Multiple Portfolios	MF-AGG		5,300	2.12	0	02/28/17
9.	UBS		ULT-AGG		4,675	1.87	0	12/30/16
10.	DIAMOND HILL CAPIT...	Multiple Portfolios	MF-AGG		4,081	1.63	330	02/28/17
11.	TIAA-CREF		ULT-AGG		3,000	1.20	0	02/28/17
12.	STANDARD INSURANC...		Sch-D		2,600	1.04	-1,100	12/31/16
13.	PUTNAM INVESTMENT...	Multiple Portfolios	MF-AGG		2,500	1.00	0	12/31/16
14.	VALIC CO I	Multiple Portfolios	MF-AGG		2,197	0.88	-28	12/31/16
15.	SWISS LIFE AG	Multiple Portfolios	MF-AGG		1,800	0.72	-200	02/29/16
16.	SUMMIT INVESTMENT ...	Multiple Portfolios	MF-AGG		1,500	0.60	0	01/31/17
17.	IG INVESTMENT MANA...	Multiple Portfolios	MF-AGG		895	0.36	0	01/31/17
18.	TOUCHSTONE ADVISO...	Multiple Portfolios	MF-AGG		852	0.34	0	12/30/16
19.	AMERICAN INTERNATI...		ULT-AGG		810	0.32	135	01/31/17

Complementing the strong operating and financial statistics on display by CACC, it is also comforting to see the concentration of the bonds among long-term, institutional investors such as Principal Financial Group, New York Life, Sun Life Financial, SEI Investments, Allstate, TIAA, Swiss Life, and AIG. Although some of the firms have lightened their exposure to CACC in the recent quarter, overall, these investors are not "traders" who are seeking to take advantage of short-term market fluctuations, and likely would not rush out of the bonds if they were to experience a slight decrease in price. These are long-term investors who are looking for extra spread over a business cycle to help them pay out their life insurance/ P&C customers.

CACC also has a long heritage of strong insider ownership. With over 50% of the shares of the company being closely held by insiders, these investors have a stronger incentive to make sure creditors are treated appropriately so that they can continue to borrow on the open market at reasonable rates. Other notable investors include Seth Klarman's Baupost, who owns a $20MM stake in the firm. With Mr. Klarman's 20% + long-term returns, he looks for deep value plays, and investments with considerable margin of safety. If he believes the common stock is safe enough for his fund, I believe that going higher up in the capital structure can only be a safer investment.



Above is a snapshot of the CACC 7 and three eighths bond maturing 3/15/2023. As is apparent, the bond carries a spread of 497 bps above the 5 year treasury with a yield to worst of 6.84%. An additional benefit to the bond is its low duration of around 3.36. During this period of rising interest rates, the implication is that this bond will suffer less than the high-yield sector in general (avg duration in the 5's).

Valuation and Revenue Drivers: In their 10k, CACC breaks out their loan balance by year, and in a separate table, also breaks out the average yield on that loan balance. In yet another table they break out the term of the loan. I built a revenue forecast by finding the average number of years' term of loans in their portfolio in a year, dividing the loan balance in that year by the term, multiplying by the yield in that year, and adding them as that year's contribution to 2017 revenue. Since the average term in 2013 was 47 months, this will be the farthest back year (on average) whose loans will contribute to 2017 earnings. To estimate 2017 revenues, I used the CAGR of loan growth for the past four years as the driver to forecast what loans would be in 2017, and used a CAGR of the average yield of the portfolio to forecast what the yield would be in 2017. I only forecast to the FYE of 2017, as it is my belief that longer forecasts are all but useless. Above is my one-year earnings forecast analysis, accompanied by fair price based on a conservative handicap of Mr. Pabrai's expert assessment. The assumptions on the cost side were relatively straightforward, based on a percentage of revenues that was shown to be stable over time.

(In millions)	For the Year Ended December 31, 2013			term(months)	years	loan contribution from year	yield	rev contribution	sum revenue		
	Dealer Loans	Purchased Loans	Total								
Balance, beginning of period	$ 1,869.40	$ 240.50	$2,109.90	47	3.916666667	$ 614.86	28.30%	$ 174.01	$ 1,011.77		$1,011.77
New Consumer Loan assignments (1)	1,356.60	124.00	1,480.60								
Principal collected on Loans receivable	(1,204.20)	(129.80)	(1,334.00)								
Accelerated Dealer Holdback payments	40.40	-	40.40								
Dealer Holdback payments	114.20	-	114.20								
Transfers (2)	(17.90)	17.90	-								
Write-offs	(5.20)	(0.10)	(5.30)								
Recoveries (3)	2.20	0.20	2.40								
Balance, end of period	$ 2,155.50	$ 252.70	$2,408.20								

(In millions)	For the Year Ended December 31, 2014									
	Dealer Loans	Purchased Loans	Total							
Balance, beginning of period	$ 2,155.50	$ 252.70	$ 2,408.20	47	3.91666667	$	694.42	26.70%	$	185.41
New Consumer Loan assignments (1)	1,471.40	204.30	1,675.70							
Principal collected on Loans receivable	(1,392.50)	(147.50)	(1,540.00)							
Accelerated Dealer Holdback payments	41.70	-	41.70							
Dealer Holdback payments	135.50	-	135.50							
Transfers (2)	(20.50)	20.50	-							
Write-offs	(3.10)	(0.10)	(3.20)							
Recoveries (3)	1.80	0.10	1.90							
Balance, end of period	$ 2,389.80	$ 330.00	$ 2,719.80							
(In millions)	For the Year Ended December 31, 2015			50	4.16666667	$	-			
	Dealer Loans	Purchased Loans	Total							
Balance, beginning of period	$ 2,389.80	$ 330.00	$ 2,719.80			$	802.82	25.80%	$	207.13
New Consumer Loan assignments (1)	1,795.10	371.90	2,167.00							
Principal collected on Loans receivable	(1,548.80)	(190.80)	(1,739.60)							
Accelerated Dealer Holdback payments	52.60	-	52.60							
Dealer Holdback payments	150.10	-	150.10							
Transfers (2)	(10.60)	10.60	-							
Write-offs	(6.40)	(0.20)	(6.60)							
Recoveries (3)	1.60	0.20	1.80							
Balance, end of period	$ 2,823.40	$ 521.70	$ 3,345.10							
A summary of changes in Loans receivable is as follows:				53	4.41666667	$	952.53	24.70%	$	235.27
(In millions)	For the Year Ended December 31, 2016									
	Dealer Loans	Purchased Loans	Total							
Balance, beginning of period	$ 2,823.40	$ 521.70	$ 3,345.10							
New Consumer Loan assignments (1)	1,881.30	754.20	2,635.50							
Principal collected on Loans receivable	(1,668.10)	(287.70)	(1,955.80)							
Accelerated Dealer Holdback payments	53.60	-	53.60							
Dealer Holdback payments	142.00	-	142.00							
Transfers (2)	(10.10)	10.10	-			$	3,064.63			
Write-offs	(14.40)	(0.40)	(14.80)							
Recoveries (3)	1.30	0.10	1.40							

(Dollars in millions)	For the Years Ended December 31,										
	2016		2015	Change	2013						
Average net Loans receivable balance $	3,534.00	$	2,829.90	$ 704.10	2088.4	**1.69220456**	**CAGR**		**4030.693364**	**2017 Loan orig. estimate**	
Average yield on our Loan portfolio	24.70%		25.80%	-1.10%	28.30%	**0.87279152**	**CAGR**	0.11321	**0.238739666**	**2017 Yield estimate**	
								1.11321			
								1.03602			
								54.9093	879.4240066	**209.95339**	**est. 2017 loan rev. contribution**

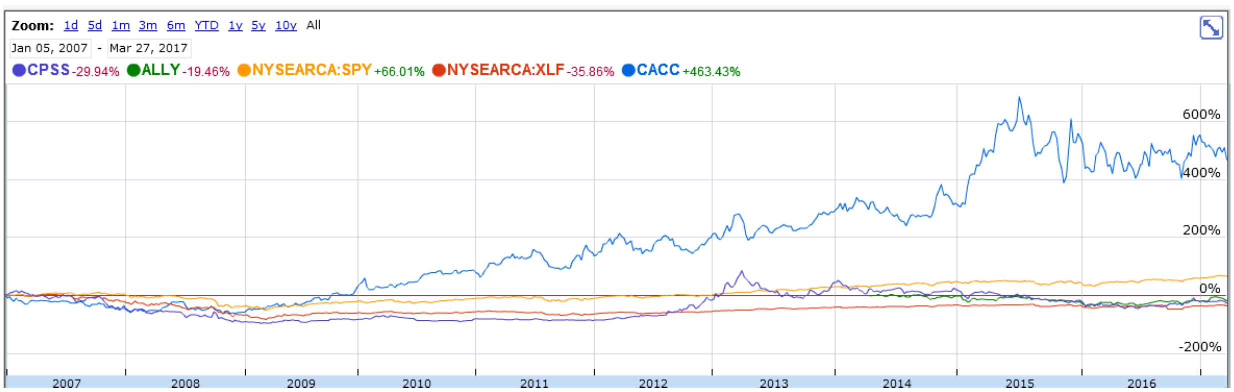
Economic Background: With the Federal Reserve poised to raise rates again, the US economy is firing on all cylinders. Unemployment is as good as it's been in 10 years, with the rate hovering just under 5%. Although rising rates could hurt equity markets as a whole, I believe that CACC will be able to successfully pass on the cost to consumers, with their new loans. Since most of these loans are fixed rate, I don't anticipate current loans being at an increased risk of default directly, except potentially for customers who have floating rate debt with other loans outstanding. Additionally, due to the aforementioned fallacious assumption that this company overly depends on auto sales, I do not expect that a year or two or three of slumping auto sales will significantly hurt their revenues. Below are charts showing how CACC performed through the past recession, as well as its stock price resilience over time.

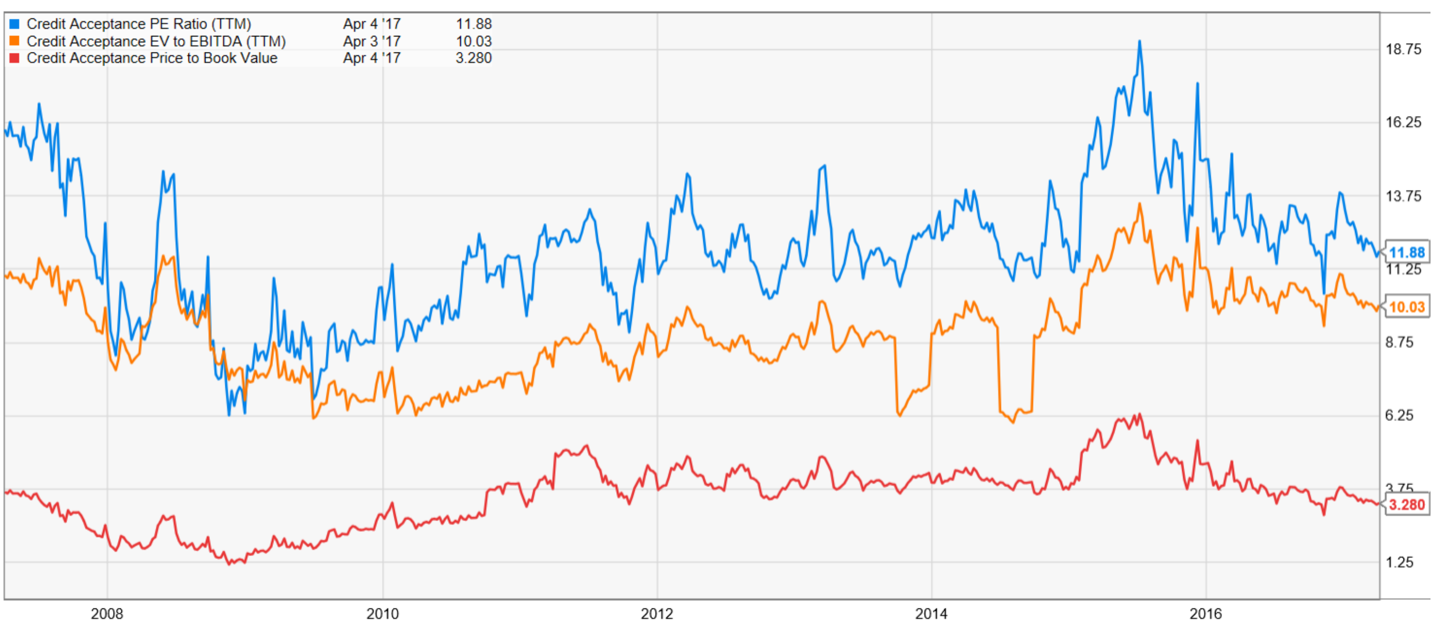
Investment Risks: The main investment risk involved is the credit risk coming from the underlying portfolio of loans, as well as the interest rate risk implied by the Fed's hints that it plans to raise rates two more times this year. If the economy worsens, this could eventually impact the existing portfolio of loans negatively. Similarly, if the scorecard methodology gets worse, or fails to accurately forecast losses, or if new management does not know how properly expand the company, there is operational risk. Finally, although I doubt if any analyst has the ability to predict "peak auto sales" with any degree of accuracy (kind of like calling the top of the stock market), if the auto sales do slump for three to four years in a row, I'd expect this to have a negative result.

Recommendation: CACC is a buy for the finance sleeve in an appropriate increment (recommend no more than 1%).

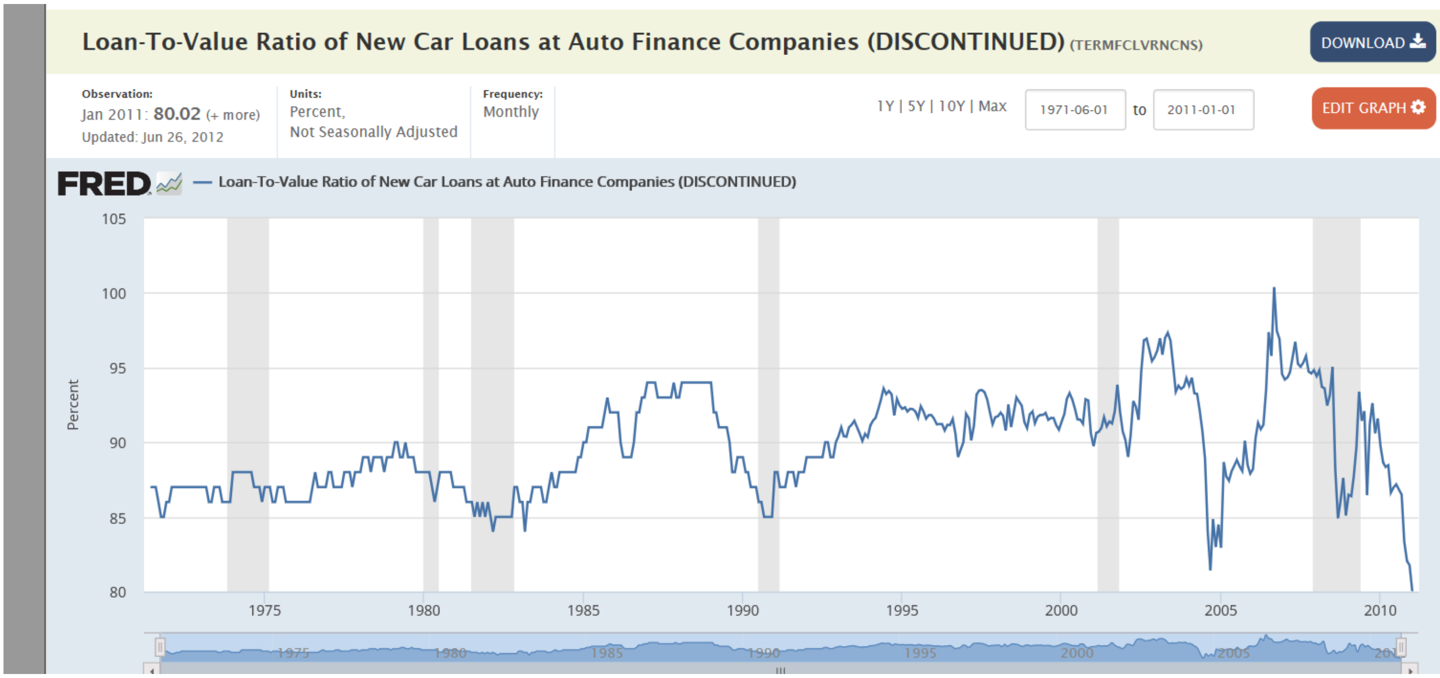
Past-recession, financial performance:

(Dollars in Thousands, Except Per Share Data)	Years Ended December 31, 2009	2008	2007	2006	2005
Income Statement Data:					
Revenue	$ 380,664	$ 312,186	$ 239,927	$ 219,332	$ 201,268
Costs and expenses:					
Salaries and wages	66,893	68,993	55,396	41,015	39,093
General and administrative(A)	30,391	27,536	27,202	36,491	19,022
Sales and marketing	14,808	16,776	17,493	16,624	14,898
Provision for credit losses	(12,164)	46,029	19,947	11,006	5,705
Interest	32,399	43,189	36,669	23,330	13,886
Provision for claims	19,299	2,651	39	226	308
Total costs and expenses	151,626	205,174	156,746	128,692	92,912
Income from continuing operations before provision for income taxes	229,038	107,012	83,181	90,640	108,356
Provision for income taxes	82,992	39,944	29,567	31,793	40,159
Income from continuing operations	146,046	67,068	53,614	58,847	68,197
Gain (loss) from operations of discontinued United Kingdom segment(B)	137	307	(562)	(297)	6,194
(Credit) provision for income taxes	(72)	198	(1,864)	(90)	1,790
Gain (loss) from discontinued operations	209	109	1,302	(207)	4,404
Net income	$ 146,255	$ 67,177	$ 54,916	$ 58,640	$ 72,601
Net income per common share:					
Basic	$ 4.78	$ 2.22	$ 1.83	$ 1.78	$ 1.96
Diluted	$ 4.62	$ 2.16	$ 1.76	$ 1.66	$ 1.85





https://global.eatonvance.com/insights.php?post=why-subprime-auto-loan-concerns-may-be-inflated



CACC US Equity | 96) Actions | 97) Output | 98) Settings | Financial Analysis

ADJ Credit Acceptance Corp | Periods 10 Annuals | Currency USD

1) Key Stats | 2) I/S | 3) B/S | 4) C/F | 5) Ratios | 6) Segments | 7) Addl | 8) ESG | 9) Custom

11) Overview | 12) Social | 13) Governance | 14) Exec & Dir Comp | 15) ESG Ratios

In Millions of USD except Per Share	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
12 Months Ending	12/31/2010	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Date of Last Executive Change	08/05/2010	06/01/2011	–	–	01/01/2014	–
# Execs Included in Compensation	5	5	5	5	6	6
CEO						
CEO Duality	No	No	No	No	No	No
Total Compensation Paid	0.8	1.0	54.3	1.0	1.0	1.0
Total Salaries and Bonuses Paid	0.8	1.0	1.0	1.0	1.0	1.0
Total Salaries Paid	0.8	0.8	1.0	1.0	1.0	1.0
Total Bonuses Paid	0.0	0.2	0.0	0.0	0.0	0.0
All Other Compensation Paid	0.0	0.0	53.3	0.0	0.0	0.0
Stock Awards Granted	0.0	0.0	53.3	0.0	0.0	0.0
Option Awards Granted	0.0	0.0	0.0	0.0	0.0	0.0
Non Equity Incentives Granted	0.0	0.0	0.0	0.0	0.0	0.0
Pension & Nonqual Defined Pension	0.0	0.0	0.0	0.0	0.0	0.0
Total Other Compensation Paid	0.0	0.0	0.0	0.0	0.0	0.0
# of CEO and Equiv Changes in FY	0	0	0	0	0	0
# CEO and Equiv Included in Comp	1	1	1	1	1	1
CEO Tenure at Fiscal Year End	9.00	10.00	11.00	12.00	13.00	14.00

Covenants		
51)	Negative Pledge	Yes
52)	Change of Control	Yes@101.00
	Fundamental Change	No
53)	Limit of Indebtedness	Yes
54)	Cross Default	Yes
	Negative Covenant	Yes
55)	Certain Sales of Assets	Yes
	Restriction on Activities	Yes
	Debt Service Coverage Ratio	No
	Free Cash Flow To Debt Service Ratio	No
	Restrictive Covenant	Yes
56)	Merger Restrictions	Yes
	Limitation on Sale-and-Leaseback	No
	Limitation on Subsidiary Debt	No
57)	Restricted Payments	Yes
	Ratings Trigger	No
	Collective Action Clause	No
	Material Adverse Change Clause	No
	Force Majeure	No