

## **Credit Acceptance Corp – The Black Swan Event**

### **Citron Predicts Either Bankruptcy or Down 80% as Subprime Auto is Forever Changed**

***“There are decades where nothing happens; and there are weeks where decades happen.”- V.I. Lenin***

Credit Acceptance Corp (CACC) has been a controversial name for years. We have avoided opining on the stock because while we didn't feel comfortable with the Company's business ethics and practices, we couldn't help but respect the fact that through aggressive and questionably legal measures it successfully became a profitable lender in the subprime auto market.

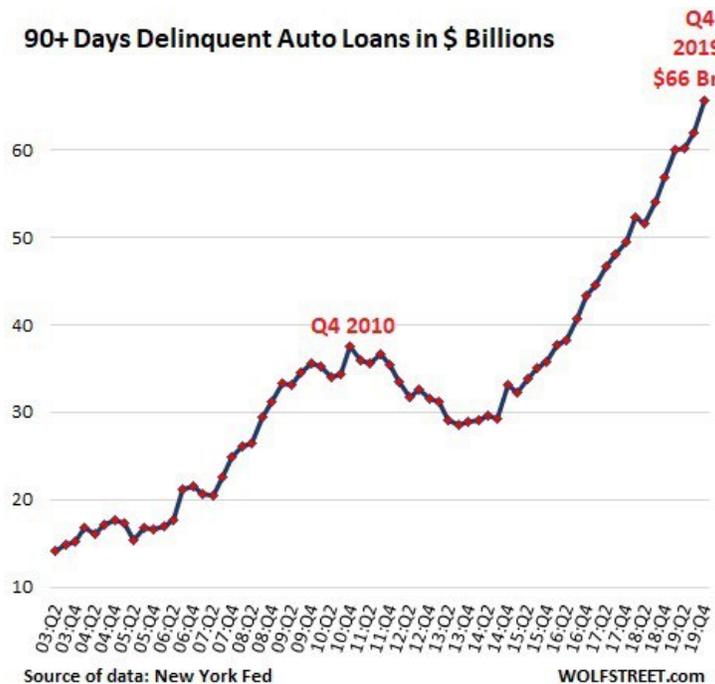
**All that has stopped in a matter of weeks and cannot come back (and the stock still trades well over book value)**

The economic effect of the COVID-19 virus has become the black swan to unemployment in the United States at a pace that defies any stress test or model ever conducted by lenders. As you read this thousands of people are defaulting on their deep subprime car loans and there is nothing Credit Acceptance can do about it. The business is in a death spiral.

The situation is so dire that the United States Department of Labor is asking states not to disclose any more unemployment data – claiming the information is an important economic indicator that could potentially impact the financial markets.

<https://abcnews.go.com/Politics/fearing-market-impact-trump-administration-asks-states-postpone/story?id=69710991>

The subprime auto market was already showing signs of stress pre COVID-19 as shown in multiple media outlets just weeks before the February market turn. (1)



Unlike the 2008 financial crisis, which was devastating to those who owned stocks and were levered in real estate, the 2020 COVID-19 economic crisis is a direct hit on the lower wage workers of America and 1099 employees whose jobless rate just skyrocketed in just the past two weeks.

As if the black swan had a twin for subprime auto credit, the credit markets have frozen and will not be open in the near future to securitize the high interest/high default, low LTC loans that are the cornerstone of CACC’s business.

What regulation could not do in 4 years; an act of nature will do in 4 weeks.

<https://www.politico.com/news/2020/03/17/coronavirus-layoffs-america-unemployment-134819>  
<https://www.cnbc.com/2020/03/19/gary-cohn-warns-us-will-have-massive-unemployment-very-very-quickly.html>  
<https://www.forbes.com/sites/sarahhansen/2020/03/20/unemployment-headed-for-40-year-high-and-trump-reportedly-tells-states-not-to-release-data/#72a6d3a52fbd>  
<https://www.nbcnews.com/politics/congress/see-who-s-eligible-coronavirus-checks-senate-gop-releases-details-n1164311>

The future of CACC will all be predicated on:

- The ability to securitize any future loans
- The huge wave of defaults on current loans
- The political pressure going forward
- The lack of government “bailout”
- The immediate slowdown in the used car market

Consider:

As we enter a new era of quasi-socialism where the government is planning to give \$1,200 checks to individuals we must ask:

*Does the government want people to use the emergency money to pay interest on a ~30% auto loan for a car that is worth 30% of the outstanding loan or does it want people to buy food and pay rent?*

*Most of all the loans outstanding are for more than 100% more than the underlying car is worth... and that number gets worse every day. Unlike real estate, the value of a 2012 Honda Accord will NEVER come back.*

With a complete halt to subprime used car sales along with a sudden shock to the American worker never seen before in this lifetime, Credit Acceptance inevitably has three possible scenarios.

## Three Scenarios

Citron will now lay out the only three possible scenarios for CACC in order of probability.

### Scenario #1 – Bankruptcy

Simple -- The credit markets have frozen for CACC and it will not be able to complete any significant securitization of future loans for at least the next year. Meanwhile, as unemployment climbs, CACC's book experiences massive defaults, as the used car loan becomes an unemployed worker's lowest priority.

**Moreover, CACC's dependence on the court system to either repossess cars or garnish wages (to the extent a borrower has wages to garnish) will fail as courts are closed or reduced in staff and facing backlogs and only handling the most pressing matters. (2)**

Worse, even if it can repossess and incur the associated costs of repossession and storage in a declining wholesale car market – what is CACC going to do with a glut of repossessed used cars in a fragile economy?

We are witnessing this nightmare scenario happening in real-time to Credit Acceptance as acknowledged by other lenders most of whom have higher quality loan portfolios.

Lenders such as Ally, Nissan, Bank of America, and Wells Fargo are offering borrowers concessions and delayed payments; CNBC has made a comprehensive list of the participating companies.

<https://www.cnbc.com/2020/03/20/what-banks-are-doing-to-help-americans-affected-by-coronavirus.html>

Notice who is absent – Credit Acceptance Corp.

For instance, while Ally is explicitly telling customers that they're allowed to defer payment for up to 120 days with no late fees, CACC has simply added instructions of how to make a payment and to call if in need of additional assistance.

← → ↻ 🏠 [creditacceptance.com/coronavirus-response](https://creditacceptance.com/coronavirus-response) ☆ 📄

## COVID-19 Update: We are here for you.

Credit Acceptance is working hard to ensure you continue to have access to the account services you need.

The safety and well-being of our customers and team members are a priority for us. In this regard, we have successfully enabled our account representatives to work from home. Our team members remain available to provide you any account support you need.

We also want to encourage our Customers to exercise social distancing and not venture out to make payments whenever possible. Keep in mind that payments can be made online or over the telephone, 24 hours a day.

### How to make a payment

- If you have a Customer Portal account you can use it to make payments and to access your account 24/7. [Click here to log into your Portal Account.](#)
- If you do not have a Customer Portal Account, you can set one up so you can make payments. [Click here to create a new Portal Account.](#)
- You can also make a one-time payment online without a portal account. [Click here to make a one-time payment.](#)
- If you would like to make a payment over the telephone, call **1-800-634-1506**. You can make a payment 24 hours a day using our automated phone system, or with the assistance of an agent during the following business hours:
  - 8:00 a.m. – 11:00 p.m. ET, Monday through Friday
  - 8:00 a.m. – 5:00 p.m. ET, Saturday and Sunday

### Additional assistance

If you are having trouble making the payment on your car due to the impact of COVID-19, please call one of our Account Representatives at **1-800-634-1506**. We will do our best to make payment arrangements that fit your current financial situation.

<https://www.creditacceptance.com/coronavirus-response>

Because CACC is a finance company and NOT a bank with deposits it does not have the right under debt covenants to waive or extend payments. We can

expect that a tidal wave of defaults has already begun, as many payments are bi-weekly.

Citron called Credit Acceptance and told a representative that our family member is under care of a doctor for COVID-19 and was told – SORRY NO DEFFERALS.

<https://citronresearch.com/wp-content/uploads/2020/03/CACC-Audio.mp3>

## Credit Acceptance Cannot Expect Help from Washington DC

Once Congress has agreed on an economic stimulus/bailout plan, it is likely that the government will use this difficult time as a country to pass long needed laws that reform auto lending practices – directly targeted at CACC.

Just look at what Jim Cramer tweeted out this week – without any company in mind. This is where our country is going.



Last week, in response to the current uncertainty in the economy Senator Warren and Senator Sherrod Brown alerted the CFPB of abusive auto lending practices. These words are a direct assault on CACC:

“The CFPB has the power to make a difference in this market,” the senators wrote. “While the agency does not have the authority to examine directly the practices of auto dealers, **it does have the authority — and the responsibility — to examine the auto lending companies** and financial institutions that provide auto loans.”

<https://thehill.com/policy/finance/overnights/487954-warren-brown-press-consumer-bureau-on-auto-lending-oversight>  
<https://www.warren.senate.gov/oversight/letters/warren-and-brown-raise-concerns-to-cfpb-about-abusive-lending-practices-in-the-auto-loan-market>

US Senator Sherrod Brown:

“Whatever relief package we do starts with workers and making sure that they can go forward with their lives, and raise their children, and stay in their homes, and have enough food, and have an expanded Medicaid and health coverage”

<https://www.theatlantic.com/politics/archive/2020/03/coronavirus-response-senator-sherrod-brown/608458/>

We can expect policy makers to look at current investigations and lawsuits against CACC as a starting point:

	<b><u>Credit Acceptance Corp</u></b>
Ongoing Investigations and Lawsuits	Attorney General of New York Bureau of Consumer Financial Protection Attorney General of Mississippi Attorney General of Maryland U.S. Department of Justice Attorney General of Massachusetts

Disturbing but true fact:

Under the Trump administration CACC founder Don Foss and his family sold 5x more in stock than the CEOs of JPM, GS, BAC, MS and WFC – COMBINED.

## **Don't Expect the Aggressive Subprime Auto Lending to Ever Look the Same**

Strong arm collections, usurious rates, garnishment of wages, and abuses of the court systems will be a black mark in US financial history as we have let laissez faire government allow this to happen.

We can write volumes on the business practices of CACC and would not even come close to the comprehensive work done by Plainsite.org.

<https://www.plainsite.org/realitycheck/creditacceptance.html>

Or for a humorous twist you can watch this John Oliver piece that came out only months before the 2016 election.

<https://www.businessinsider.com/john-oliver-explains-auto-lending-2016-8?r=MX&IR=T>

**Sometimes you need tragedy to affect positive change – and that is what we got.**

### **Other Scenarios in which CACC survives**

Citron does not see how bankruptcy can be avoided. But, to play devil's advocate we will present two other scenarios... neither of which is too pretty. In order to understand both scenarios we must first look at where CACC trades on price to book compared to other banks and subprime lenders.

	<u>Before COVID-19</u>	<u>Current</u>
CACC	3.4x	2.4x
SC	1.3x	0.8x
ALLY	0.9x	0.4x
NICK	0.6x	0.4x
CPSS	0.5x	0.2x
Subprime Peer Average	0.8x	0.5x
<i>% Discount to CACC</i>	<i>(76%)</i>	<i>(81%)</i>
JPM	1.8x	1.2x
BAC	1.3x	0.8x
WFC	1.2x	0.7x
MS	1.2x	0.8x
GS	1.1x	0.7x
Best in Class Financial Average	1.3x	0.8x
<i>% Discount to CACC</i>	<i>(61%)</i>	<i>(65%)</i>

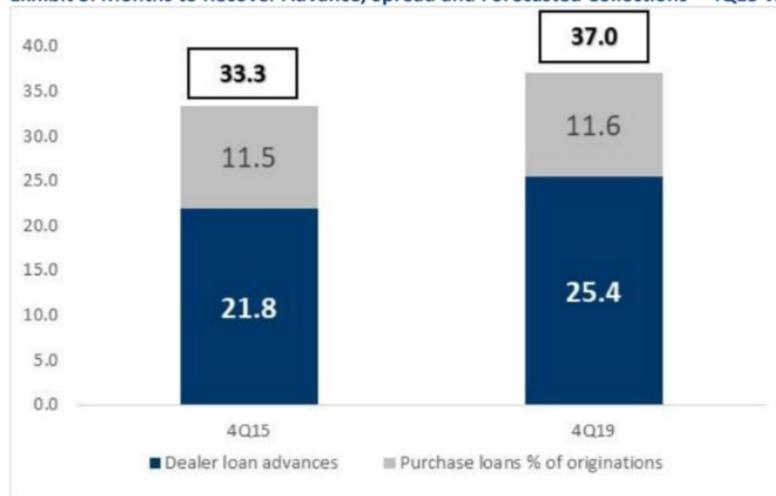
	<u>Best in Class Financial Average</u>	<u>Subprime Peer Average</u>
Price to Book Multiple	0.8x	0.5x
CACC Implied Stock Price	\$100	\$63
<i>% Downside</i>	<i>(68%)</i>	<i>(80%)</i>

## Scenario #2 – CACC Reverts to Trading at a Significant Discount to Book

Let's be realistic. What is the value of a \$25k loan when the car is worth \$8k and the fees and interest are the remaining \$17k while your customer has a FICO score of less than 500 and you will have difficulty in repossessing the vehicle?

Over the years CACC has been taking on riskier and lower return loans and hiding the true volatility of its earnings through aggressive accounting.

Exhibit 3: Months to Recover Advance, Spread and Forecasted Collections – 4Q15 vs. 4Q19



Source: BTIG Estimates and Company Documents

CACC has appeared to lever up its customers more than ever.

CACC's average loan originated in Q4'15 had an average monthly payment of \$326 but has increased to over \$400 in 2019 even though the average income of CACC's borrowers has been stable year after year between \$40K and \$45K.

However, given mass unemployment, this is all fantasy talk.

Assuming the credit markets stay open but the market factors in potential regulation and defaults, CACC could trade at 0.5x book or \$60 a share.

See below Appendix 3 for explanation.

### **Scenario #3 – Black Swan was actually a White Swan in disguise**

If somehow miraculously in the next few weeks there is a cure or effective treatment for COVID-19, the credit markets open wide, the economy is able to quickly stabilize, employment rebounds, and the stock market goes higher, then Credit Acceptance can trade at just under book value in-line with where its subprime lender comps were trading before COVID-19.

In this scenario we must pretend that nobody steps up to defend the working class and the rising unemployment was only a 3-month phenomenon.

Complete Fantasy but we will put it out there.

You can look at the book value tables above and manipulate the numbers all you want but the conclusion remains the same:

Credit Acceptance is the most vulnerable name in the stock market.

## Conclusion

We live in a new reality and it happened so fast that it is difficult for anyone to absorb. While critics of CACC long thought the company would go through a slow unwind process because of economic headwinds and long, drawn-out regulatory action – everything just happened in two weeks.

***“There are decades where nothing happens; and there are weeks where decades happen.”- V.I. Lenin***

## Cautious Investing and Social Distancing to All

**(1)** This is the ironic headline out from an article that analyzes the recent NY Fed minutes that was published on **Feb 11, 2020**.

***Subprime Auto Loans Explode, “Serious Delinquencies” Spike to Record. But There’s No Jobs Crisis, These Are the Good Times”***

The subprime auto problem that was best forecasted in that article in February has become reality in just weeks.

### ***Why are subprime delinquencies surging like this?***

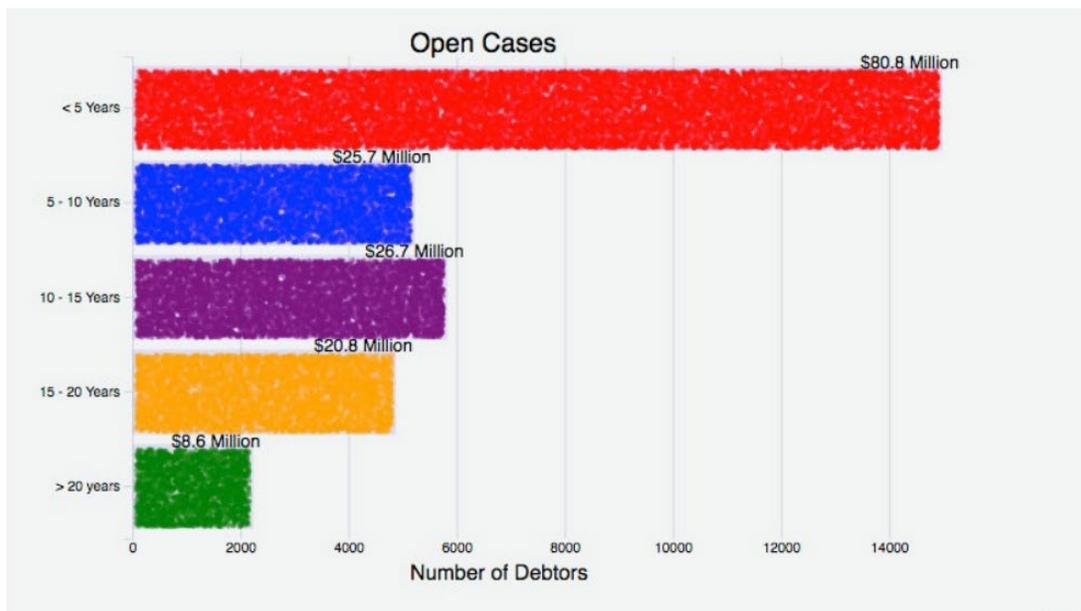
*It’s not the economy. That will come later when the employment cycle turns and people lose their jobs. And those delinquencies due to job losses will be on top of what we’re seeing now. It’s how aggressive the subprime lending industry has gotten, and how they’ve been able to securitize these loans and selling the ABS into heavy demand from investors who have gotten beaten up by negative-interest-rate and low-interest-rate policies of central banks.*

<https://wolfstreet.com/2020/02/11/subprime-auto-loans-explode-serious-delinquencies-spike-to-record-but-theres-no-jobs-crisis-these-are-the-good-times/>

Talk about timing, here is the WSJ explaining the same problem on Feb 15, 2020.

<https://www.wsj.com/articles/dealerships-give-car-buyers-some-advice-just-stop-paying-your-loan-11581762601>

**(2)** *“In 2017, one out of every eight civil lawsuits filed in Detroit's 36th District Court, the largest district court in the state of Michigan, was a collection case brought by Credit Acceptance, according to an analysis of publicly available court records by Jalopnik. Credit Acceptance alone — a company meant to service subprime car loans under the cheerful motto of "We change lives!" — absolutely dominates the civil case volume of one of the country's busiest courts.”*



The chart above represents Open Credit Acceptance Debt Collection cases, or cases in which the defendant(s) has not yet satisfied the judgment(s) against them. The numbers on the left indicate how long the cases in that category have been open. The numbers at the bottom indicate how many defendants there are in all cases in a given category. The numbers atop each bar indicate how much money has been secured in judgments against all the defendants in all cases in that category.

<https://www.metrotimes.com/detroit/how-a-subprime-auto-lender-consumed-detroit-with-debt-and-turned-its-courthouse-into-a-collections-agency/Content?oid=17405276>

**(3)** This is what a typical loan situation looks like at CACC and why book value is so difficult to judge.

A dealer buys car at auction for \$9,500. Dealer sells car for \$14,500. Buyer gets 7-year loan originated by CACC at the dealer level. CACC adds fees and insurance

(e.g., gap, disability, death, etc.). Total price to customer with tax is \$17,500-\$18,500. Car gets driven off lot and is back to about \$9,000 value first day off the lot but after a year the value drops to \$7,500 as it depreciates. Loan gets added fees as payments are late. After a year the loan owed can move above \$20k and the car gets repossessed and their paychecks get docked after the court order. **So, this >\$20k is what comprises CACC's book.**

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