CREDIT ACCEPTANCE CORP
Form 10-Q
April 29, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2010

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission File Number 000-20202

CREDIT ACCEPTANCE CORPORATION

(Exact name of registrant as specified in its charter)

MICHIGAN	**38-1999511**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
25505 WEST TWELVE MILE ROAD SOUTHFIELD, MICHIGAN	**48034-8339**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: 248-353-2700

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

The number of shares of Common Stock, par value $0.01, outstanding on April 23, 2010 was 31,019,762.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)

	Three Months Ended March 31,	
(Dollars in thousands, except per share data)	2010	2009
Revenue:		
Finance charges	$ 89,663	$ 76,726
Premiums earned	7,704	6,460
Other income	5,895	4,702
Total revenue	103,262	87,888
Costs and expenses:		
Salaries and wages	16,110	17,121
General and administrative	6,542	7,995
Sales and marketing	4,810	3,921
Provision for credit losses	6,426	164
Interest	11,705	7,923
Provision for claims	5,212	4,809
Total costs and expenses	50,805	41,933
Income from continuing operations before provision for income taxes	52,457	45,955
Provision for income taxes	20,442	16,943
Income from continuing operations	32,015	29,012
Discontinued operations		
Loss from discontinued United Kingdom operations	(5)	(15)
Provision (benefit) for income taxes		(4)
Loss from discontinued operations	(5)	(11)
Net income	$ 32,010	$ 29,001
Net income per common share:		
Basic	$ 1.03	$ 0.95

Diluted	$	1.01	$	0.93
Income from continuing operations per common share:				
Basic	$	1.03	$	0.95
Diluted	$	1.01	$	0.93
Loss from discontinued operations per common share:				
Basic	$		$	
Diluted	$		$	
Weighted average shares outstanding:				
Basic		31,042,495		30,479,665
Diluted		31,584,326		31,180,146

See accompanying notes to consolidated financial statements.

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CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED BALANCE SHEETS

(Dollars in thousands, except per share data)	March 31, 2010 (Unaudited)	As of December 31, 2009
ASSETS:		
Cash and cash equivalents	$ 1,602	$ 2,170
Restricted cash and cash equivalents	87,148	82,456
Restricted securities available for sale	3,072	3,121
Loans receivable (including $11,952 and $12,674 from affiliates as of March 31, 2010 and December 31, 2009, respectively)	1,211,486	1,167,558
Allowance for credit losses	(123,144)	(117,545)
Loans receivable, net	1,088,342	1,050,013
Property and equipment, net	18,324	18,735
Income taxes receivable	787	3,956
Other assets	28,481	15,785
Total Assets	$ 1,227,756	$ 1,176,236
LIABILITIES AND SHAREHOLDERS EQUITY:		
Liabilities:		
Accounts payable and accrued liabilities	$ 102,582	$ 77,295
Line of credit	28,400	97,300
Secured financing	221,167	404,597
Mortgage note and capital lease obligations	4,875	5,082
Senior notes	243,845	
Deferred income taxes, net	88,251	93,752
Income taxes payable	7,852	
Total Liabilities	696,972	678,026
Shareholders Equity:		
Preferred stock, $.01 par value, 1,000,000 shares authorized, none issued		
Common stock, $.01 par value, 80,000,000 shares authorized, 31,012,513 and 31,038,217 shares issued and outstanding as of March 31, 2010 and December 31, 2009, respectively	310	311
Paid-in capital	24,631	24,370
Retained earnings	506,443	474,433
Accumulated other comprehensive loss, net of tax of $348 and $526 at March 31, 2010 and December 31, 2009, respectively	(600)	(904)

Total Shareholders Equity	530,784	498,210
Total Liabilities and Shareholders Equity	$ 1,227,756	$ 1,176,236

See accompanying notes to consolidated financial statements.

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CREDIT ACCEPTANCE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Three Months Ended March 31,	
(Dollars in thousands)	**2010**	**2009**
Cash Flows From Operating Activities:		
Net income	$ 32,010	$ 29,001
Adjustments to reconcile cash provided by operating activities:		
Provision for credit losses	6,426	164
Depreciation and amortization	1,299	1,371
(Benefit) provision for deferred income taxes	(5,679)	3,541
Stock-based compensation	1,183	1,484
Change in operating assets and liabilities:		
Increase in accounts payable and accrued liabilities	25,776	11,187
Decrease in income taxes receivable / increase in income taxes payable	11,021	7,330
Increase in other assets	(12,696)	(4,601)
Net cash provided by operating activities	59,340	49,477
Cash Flows From Investing Activities:		
Increase in restricted cash and cash equivalents	(4,692)	(6,658)
Purchases of restricted securities available for sale	(407)	
Maturities of restricted securities available for sale	449	207
Principal collected on Loans receivable	206,137	177,045
Advances to Dealer-Partners and accelerated payments of Dealer Holdback	(212,317)	(153,181)
Purchases of Consumer Loans	(26,443)	(41,389)
Payments of Dealer Holdback	(12,170)	(12,811)
Net decrease (increase) in other loans	38	(13)
Purchases of property and equipment	(781)	(809)
Net cash used in investing activities	(50,186)	(37,609)
Cash Flows From Financing Activities:		
Borrowings under line of credit	99,900	152,300
Repayments under line of credit	(168,800)	(114,300)
Proceeds from secured financing		54,900
Repayments of secured financing	(183,430)	(107,210)
Principal payments under mortgage note and capital lease obligations	(207)	(377)
Proceeds from sale of senior notes	243,738	
Repurchase of common stock	(1,896)	(540)
Proceeds from stock options exercised	19	156
Tax benefits from stock-based compensation plans	954	153
Net cash used in financing activities	(9,722)	(14,918)
Effect of exchange rate changes on cash		2

Net decrease in cash and cash equivalents		(568)		(3,048)
Cash and cash equivalents, beginning of period		2,170		3,154
Cash and cash equivalents, end of period	$	1,602	$	106
Supplemental Disclosure of Cash Flow Information:				
Cash paid during the period for interest	$	13,443	$	8,729
Cash paid during the period for income taxes	$	5,126	$	5,557

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles or GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of actual results achieved for full fiscal years. The consolidated balance sheet at December 31, 2009 has been derived from the audited financial statements at that date but does not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Annual Report on Form 10-K for the year ended December 31, 2009 for Credit Acceptance Corporation (the Company , Credit Acceptance , we , our or us). Certain prior period amounts have been reclassified to conform to the current presentatio

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

We have evaluated events and transactions occurring subsequent to the consolidated balance sheet date of March 31, 2010 for items that could potentially be recognized or disclosed in these financial statements.

2. DESCRIPTION OF BUSINESS

Since 1972, Credit Acceptance has provided auto loans to consumers, regardless of their credit history. Our product is offered through a nationwide network of automobile dealers who benefit from sales of vehicles to consumers who otherwise could not obtain financing; from repeat and referral sales generated by these same customers; and from sales to customers responding to advertisements for our product, but who actually end up qualifying for traditional financing.

We refer to dealers who participate in our programs and who share our commitment to changing consumers lives as Dealer-Partners . Upon enrollment in our financing programs, the Dealer-Partner enters into a dealer servicing agreement with us that defines the legal relationship between Credit Acceptance and the Dealer-Partner. The dealer servicing agreement assigns the responsibilities for administering, servicing, and collecting the amounts due on retail installment contracts (referred to as Consumer Loans) from the Dealer-Partners to us. A consumer who does not qualify for conventional automobile financing can purchase a used vehicle from a Dealer-Partner and finance the purchase through us. We are an indirect lender from a legal perspective, meaning the Consumer Loan is originated by the Dealer-Partner and assigned to us.

We have two programs: the Portfolio Program and the Purchase Program. Under the Portfolio Program, we advance money to Dealer-Partners (referred to as a Dealer Loan) in exchange for the right to service the underlying Consumer Loan. Under the Purchase Program, we buy the Consumer Loan from the Dealer-Partner (referred to as a Purchased Loan) and keep all amounts collected from the consumer. Dealer Loans and Purchased Loans are collectively referred to as Loans . The following table shows the percentage of Consumer Loans assigned to us under each of the programs for each of the last five quarters:

Quarter Ended	Portfolio Program	Purchase Program
March 31, 2009	82.3%	17.7%
June 30, 2009	86.0%	14.0%
September 30, 2009	89.0%	11.0%
December 31, 2009	90.8%	9.2%
March 31, 2010	90.9%	9.1%

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

2. DESCRIPTION OF BUSINESS (Continued)

Portfolio Program

As payment for the vehicle, the Dealer-Partner generally receives the following:

- a down payment from the consumer;
- a non-recourse cash payment (advance) from us; and
- after the advance has been recovered by us, the cash from payments made on the Consumer Loan, net of certain collection costs and our servicing fee (Dealer Holdback).

We record the amount advanced to the Dealer-Partner as a Dealer Loan, which is classified within Loans receivable in our consolidated balance sheets. Cash advanced to Dealer-Partners is automatically assigned to the originating Dealer-Partner s open pool of advances. We require Dealer-Partners to group advances into pools of at least 100 Consumer Loans. At the Dealer-Partner s option, a pool containing at least 100 Consumer Loans can be closed and subsequent advances assigned to a new pool. All advances due from a Dealer-Partner are secured by the future collections on the Dealer-Partner s portfolio of Consumer Loans assigned to us. For Dealer-Partners with more than one pool, the pools are cross-collateralized so the performance of other pools is considered in determining eligibility for Dealer Holdback. We perfect our security interest in the Dealer Loans by taking possession of the Consumer Loans, which list us as lien holder on the vehicle title.

The dealer servicing agreement provides that collections received by us during a calendar month on Consumer Loans assigned by a Dealer-Partner are applied on a pool-by-pool basis as follows:

- First, to reimburse us for certain collection costs;
- Second, to pay us our servicing fee, which generally equals 20% of collections;
- Third, to reduce the aggregate advance balance and to pay any other amounts due from the Dealer-Partner to us; and
- Fourth, to the Dealer-Partner as payment of Dealer Holdback.

Dealer-Partners have an opportunity to receive an accelerated Dealer Holdback payment at the time a pool of 100 or more Consumer Loans is closed. The amount paid to the Dealer-Partner is calculated using a formula that considers the forecasted collections and the advance balance on the closed pool. If the collections on Consumer Loans from a Dealer-Partner s pool are not sufficient to repay the advance balance and any other amounts due to us, the Dealer-Partner will not receive Dealer Holdback.

Since typically the combination of the advance and the consumer s down payment provides the Dealer-Partner with a cash profit at the time of sale, the Dealer-Partner s risk in the Consumer Loan is limited. We cannot demand repayment of the advance from the Dealer-Partner except in the event the Dealer-Partner is in default of the dealer servicing agreement. Advances are made only after the consumer and Dealer-Partner have signed a Consumer Loan contract, we have received the original Consumer Loan contract and supporting documentation, and we have approved all of the related stipulations for funding. The Dealer-Partner can also opt to repurchase Consumer Loans that have been assigned to us under the Portfolio Program, at their discretion, for a fee.

For accounting purposes, the transactions described under the Portfolio Program are not considered to be loans to consumers. Instead, our accounting reflects that of a lender to the Dealer-Partner. The classification as a Dealer Loan for accounting purposes is primarily a result of (1) the Dealer-Partner s financial interest in the Consumer Loan and (2) certain elements of our legal relationship with the Dealer-Partner. For each individual Dealer-Partner, the amount of the Dealer Loan recorded in Loans receivable is comprised of the following:

- the aggregate amount of all cash advances to the Dealer-Partner;
- finance charges;
- Dealer Holdback payments;
- accelerated Dealer Holdback payments; and
- recoveries.

Less:

- collections (net of certain collection costs); and write-offs.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

2. DESCRIPTION OF BUSINESS (Concluded)

Purchase Program

The Purchase Program differs from our Portfolio Program in that the Dealer-Partner receives a single payment from us at the time of origination instead of a cash advance and Dealer Holdback. For accounting purposes, the transactions described under the Purchase Program are considered to be originated by the Dealer-Partner and then purchased by us. The amount of Purchased Loans recorded in Loans receivable is comprised of the following:

- the aggregate amount of all amounts paid to purchase Consumer Loans from Dealer-Partners;
- finance charges; and
- recoveries.

Less:

- collections (net of certain collection costs); and
- write-offs.

Program Enrollment

Dealer-Partners that enroll in our programs have two enrollment options available to them. The first enrollment option allows Dealer-Partners to assign Consumer Loans under the Portfolio Program and requires payment of an upfront, one-time fee of $9,850. The second enrollment option, which became effective September 1, 2009, allows Dealer-Partners to assign Consumer Loans under the Portfolio Program and requires payment of an upfront, one-time fee of $1,950 and an agreement to allow us to keep 50% of their first accelerated Dealer Holdback payment. Prior to September 1, 2009, Dealer-Partners who chose the second enrollment option did not pay an upfront fee but agreed to allow us to keep 50% of their first accelerated Dealer Holdback payment. For all Dealer-Partners enrolling in our program after August 31, 2008, access to the Purchase Program is only granted after the first accelerated Dealer Holdback payment has been made under the Portfolio Program.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reinsurance

VSC Re Company (VSC Re), our wholly-owned subsidiary, is engaged in the business of reinsuring coverage under vehicle service contracts sold to consumers by Dealer-Partners on vehicles financed by us. VSC Re currently reinsures vehicle service contracts that are underwritten by one of our two third party insurers. Vehicle service contract premiums, which represent the selling price of the vehicle service contract to the consumer, less commissions and certain administrative costs, are contributed to trust accounts controlled by VSC Re. These premiums are used to fund claims covered under the vehicle service contracts. VSC Re is a bankruptcy remote entity. As such, the exposure to fund claims is limited to the amount of premium dollars contributed, less amounts earned and withdrawn, plus $0.5 million of equity contributed.

Premiums from the reinsurance of vehicle service contracts are recognized over the life of the policy in proportion to expected costs of servicing those contracts. Expected costs are determined based on our historical claims experience. Claims are expensed through a provision for claims in the period the claim was incurred. Capitalized acquisition costs are comprised of premium taxes and are amortized as general and administrative expense over the life of the contracts in proportion to premiums earned. A summary of reinsurance activity is as follows (dollars in thousands):

	Three Months Ended March 31,	
	2010	**2009**
Net assumed written premiums	$ 10,270	$ 9,339
Net premiums earned	7,705	6,455
Provision for claims	5,215	4,807

Amortization of capitalized acquisition costs	218	118

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

We are considered the primary beneficiary of the trusts and as a result, the trusts have been consolidated on our balance sheet. The trust assets and related reinsurance liabilities are as follows (dollars in thousands):

	Balance Sheet location	March 31, 2010	December 31, 2009
Trust assets	Restricted cash and cash equivalents	$ 43,185	$ 39,127
Unearned premium	Accounts payable and accrued liabilities	24,394	21,180
Claims reserve (1)	Accounts payable and accrued liabilities	1,032	965

(1) The claims reserve is estimated based on historical claims experience.

Prior to the formation of VSC Re, our agreements with two of our vehicle service contract third party administrators (TPAs) allowed us to receive profit sharing payments depending upon the performance of the vehicle service contract programs. The agreements also required that vehicle service contract premiums be placed in trust accounts. Funds in the trust accounts were utilized by the TPA to pay claims on the vehicle service contracts. Upon the formation of VSC Re during the fourth quarter of 2008, the unearned premiums on the majority of the vehicle service contracts that had been written through these two TPAs were ceded to VSC Re along with any related trust assets. Vehicle service contracts written prior to 2008 through one of the TPAs remain under this profit sharing arrangement. Profit sharing payments, if any, on the vehicle service contracts are distributed to us periodically after the term of the vehicle service contracts have substantially expired provided certain loss rates are met. We are considered the primary beneficiary of the trusts and as a result, the assets of the remaining trust and the related liabilities have been consolidated on our balance sheet. As of March 31, 2010 and December 31, 2009, the remaining trust had $4.3 million in assets available to pay claims and a related claims reserve of $3.5 million. The trust assets are included in restricted cash and cash equivalents and restricted securities available for sale. The claims reserve is included in accounts payable and accrued liabilities in the consolidated balance sheets. A third party insures claims in excess of funds in the trust accounts.

Our determination to consolidate the VSC Re trusts and the profit sharing trusts was based on the following:

First, we determined that the trusts qualified as variable interest entities. The trusts have insufficient equity at risk as no parties to the trusts were required to contribute assets that provide them with any ownership interest.

Next, we determined that we have variable interests in the trusts. We have a residual interest in the assets of the trusts, which is variable in nature, given that it increases or decreases based upon the actual loss experience of the related service contracts. In addition, VSC Re is required to absorb any losses in excess of the trusts assets.

Next, we evaluated the purpose and design of the trusts. The primary purpose of the trusts is to provide TPAs with funds to pay claims on vehicle service contracts and to accumulate and provide us with proceeds from investment income and residual funds.

Finally, we determined that we are the primary beneficiary of the trusts. We control the amount of premium written and placed in the trusts through Consumer Loan assignments under our Programs, which is the activity that most significantly impacts the economic performance of the trusts. We have the right to receive benefits from the trusts that could potentially be significant. In addition, VSC Re has the obligation to absorb losses of the trusts that could potentially be significant.

Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents increased to $87.1 million at March 31, 2010 from $82.5 million at December 31, 2009. The following table summarizes restricted cash and cash equivalents:

	As of	
(in thousands)	**March 31, 2010**	**December 31, 2009**
Cash collections related to secured financings	$ 42,725	$ 42,115
Cash held in trusts for future vehicle service contract claims (1)	44,423	40,341
Total restricted cash and cash equivalents	$ 87,148	$ 82,456

(1) The unearned premium and claims reserve associated with the trusts are included in accounts payable and accrued liabilities in the consolidated balance sheets.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(UNAUDITED)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Restricted Securities Available for Sale

Restricted securities available for sale consist of amounts held in accordance with vehicle service contract trust agreements. We determine the appropriate classification of our investments in debt securities at the time of purchase and reevaluate such determinations at each balance sheet date. Debt securities for which we do not have the intent or ability to hold to maturity are classified as available for sale, and stated at fair value with unrealized gains and losses, net of income taxes included in the determination of comprehensive income and reported as a component of shareholders equity.

Restricted securities available for sale consisted of the following:

	As of March 31, 2010			
(in thousands)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government and agency securities	$ 726	$ 14	$ (2)	$ 738
Corporate bonds	2,338	6	(10)	2,334
Total restricted securities available for sale	$ 3,064	$ 20	$ (12)	$ 3,072

	As of December 31, 2009			
(in thousands)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
US Government and agency securities	$ 726	$ 18	$ (2)	$ 742
Corporate bonds	2,381	7	(9)	2,379
Total restricted securities available for sale	$ 3,107	$ 25	$ (11)	$ 3,121

The cost and estimated fair values of debt securities by contractual maturity were as follows (securities with multiple maturity dates are classified in the period of final maturity). Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	As of March 31, 2010		As of December 31, 2009	
(in thousands)	Cost	Estimated Fair Value	Cost	Estimated Fair Value
Contractual Maturity				
Within one year	$ 1,389			