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GM Financial

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Jon Rau: Morning. Thanks for joining us today. My name is Jon Rau. I cover the investment-grade auto credit sector here at J.P. Morgan, along with my associate Nevin Mathew. Pleased to have with us today Dan Berce, President and CEO of GM Financial, along with his team, Susan Sheffield, CFO and EVP, and Steve Jones, Vice President, Investor Relations.

Dan's been President and CEO of GM Financial and its predecessor entity since August 2005. He was previously President of the firm 2003 to 2005 and CFO for a long time prior to that. Dan, great to have you here. Maybe just to kick things off, we could talk a little bit about the recent quarter, some of the key takeaways there, and how you're thinking about the second half of the year.

Dan Berce: Thanks, Jon, and pleased to be here today. GMF had another good quarter in the second quarter of 2022. We earned 1.1 billion pre-tax. Interesting that that was our eighth consecutive quarter of over a billion dollars of pre-tax earnings. We'd never hit that threshold before.

We've been the beneficiaries for about two years running now of strong used car pricing, and also exceptional consumer credit. Those were the two big tailwinds that we've enjoyed for the last two years. The second quarter was no exception, we saw nice games on our residual book and also really good consumer credit.

Our earnings were down year over year. If you look at just quarter-over-quarter, we are in 1.5 billion a year ago in the second quarter. The reason things are trending down a bit is not because used car prices are a lot less or consumer credit's deteriorating. It's really because our lease book is smaller. There's been less leasing activity in the industry and for GM.

We've got fewer cars coming off a lease. We also slowed down depreciation on our lease book, which has the effect of pulling ahead games a bit because your netbook values are higher and your gains are consequently lower. Strong quarter overall, and expect things to continue at a nice level.

Jon: Sitting in on presentations yesterday and a bit today, a big focus on the US consumer. You guys certainly have a unique vantage point there. When you look across the portfolio, leases and loans, prime and subprime, new and used, how are credit trends holding up?

Dan: Jon, that was question number one in every single one-on-one we had over the last two days. How is consumer credit? We look at it in a pretty granular way. Being a big captive, we do new car, we do used car, we do prime, near-prime, subprime, and we do non-GM business, so we've got a pretty good cut at how things look.

Just to, again, break things down, about 85 percent of our loan portfolio, which is total 60 billion, 85 percent of that's GM new-car finance. Out of that, 70 percent is prime, and 15 percent near-prime, and, say, 15 percent subprime, in general.

Across the board for our new-car portfolio, it's performing exceptionally well. By that, I mean degrees better than 2019, and 2019 was a good year. That was a year that we would take over and over again.

Of course, we had the big pandemic benefit in '20 and '21, so things are normalizing a bit in that new-car portfolio. Regardless of credit tier, it's performing, at this point, much better than '19, as I said.

When you look at our used book, a little different story. That's where we see a delineation between the prime customer and the subprime. The prime customer is still performing quite well. Again, much better than 2019.

On the subprime book, we've seen a used book, we've seen a normalization to the point where recent vintages are performing about like '19, maybe even slightly worse. That's where the normalization is taking place.

Jon: Thank you. Think about just the General Motors portfolio or product offering and how it's transformed over the last five or so years, the de-emphasis of sedans, more truck and SUV models, higher trim levels. Have you noticed any shift in the average income of your customer base, the GM financial customer base, over that time period?

Dan: Yeah, we have. Average transaction prices for GM product are up substantially over the last couple of years. Part of it is what you mentioned, Jon. It's just mix is different. Less sedans, more SUVs, but pricing period is firmer than it was two years ago just because of the supply

constraints, supply not quite there to meet demand.

Our amounts financed are meaningfully higher than they were a couple years ago. When we underwrite, we're underwriting to affordability of a monthly payment. On a higher transaction price, higher amount financed, of course, the monthly payment is going to be higher. That's driven a better demographic for us.

Our average customer gross income is up a good 40 percent over the last couple years. Again, commensurate with the higher transaction prices that I just mentioned.

Jon: Obviously, rates have moved a lot and, again, more so today, alongside folks trying to figure out what's going on with inflation. Thinking about interest rate impact on leases and loan payments, maybe walk us through some of the math there. Should we be looking at a three-year Treasury given the average asset in your portfolio as a proxy for the rates to follow?

Dan: Exactly, Jon. On our loan book, the average originated term of a loan is a little short of 72 months. What, 70, Susan? We do loans as long as 84 months and then as short as 36. Again, the average is just short of 72.

With pre-payments, and every loan is monthly amortizing, that drives average term of, say, two to three years. That two to three-year Treasury would be a good proxy for where we set our customer pricing. That benchmark has gone up quite a bit over the last six months.

We've raised our pricing pretty much in lockstep with that benchmark going up. Put it in perspective. On a six-year loan, a percentage point of interest, 100 basis points of interest would be \$15 or \$20 a month. It hasn't been that damaging to the monthly payments.

You layer on the average transaction price increase I talked about, and you get to a different affordability level, which is, again, why our customer demographic, on average, has improved. Their gross monthly income has improved.

On our loan book, we're originating about, on average, 740 FICO today. When I talked about it being 70 percent prime, it is a real solid book which, again, on the new car side is why we're not really seeing customer deterioration on the credit side.

Jon: Maybe just to follow up on that. With some of these big moves we've seen in rates, typically, how long is the lag period between when rates move relative to when you're able to, I

guess, push that out across the contracts you're underwriting?

Dan: We typically attempt to feather in rate increases instead of when prime goes up, the banks raise immediately the next day. We typically try to feather in the increases because, especially in the used car side, we're competing against credit unions, banks, and other lenders. There's typically, let's say, a 60-day lag before we can fully price in a benchmark increase, Jon.

Jon: Thank you. Maybe shifting gears a little bit. Can we talk a little on used cars, the outlook, what you're expecting there for the back half of the year?

Dan: Behind consumer credit, that was probably question number two.

[laughter]

Dan: What's happening with used car pricing? It's pretty well-publicized that used car values are at very high levels. What's most important to us is what is a three-year car worth. Our lease book is almost always a 36-month term. The residual, important to us, is what's happening after three years.

Manheim Index is one proxy for used car values. It's an index regardless of age, regardless of condition, regardless of mileage. We really try to pinpoint that three-year-old car, 30,000 miles. That particular vehicle, at its peak, in late 2021, was up probably 40 percent in value. It pretty much stayed in that zip code, maybe a little down, through spring of this year.

Last couple months, we've seen about a 50 basis point a week decline. When you start at 40 percent, you can have 50 basis points for a long time before things get back to anywhere where they were. That being said, car values are still, today, some 20 percent or more higher than where they were before this all started.

Our expectation is, we will continue to see a drift down in that particular used car value. By drift down, we're not expecting a cliff, but things will normalize. We're not expecting a cliff. We're expecting a drift, as I describe it, simply because the supply dynamics out there are still really favorable for used car pricing.

We're at a SAAR of, what, not even 14 million, so that supply is still not meeting demand. Their leasing activity period, across the industry, for GM, is a lot less today than it was just a few years back. There'll be fewer cars coming off lease.

Fleet activity, whether it's to the rent car companies or fleets in general, is way down. That supply isn't coming at us. We feel pretty good about normalization being a very steady trend. In fact, we see first half of '23 being quite strong, maybe reaching normalization later in '23.

Jon: Thanks. Maybe along similar lines, with this appreciation we've seen in used vehicle prices, do you track consumer equity in loans? I guess, for consumers that continue to trade in vehicles, to what extent is the higher trade-in value an offset to higher monthly payments?

Dan: Jon, We track customer equity very, very carefully, part because, as a captive, we have an interest in helping GM and GM dealers sell cars. When a customer is in equity -- let's say they're two or three years even into their loan -- we could identify that equity.

Then we send a lead to the dealer. The dealer can call the customer and say, "Hey, if you bring this car in, you've got \$5,000 of equity. We can use that to buy a new car, make a down payment, buy a new car." We're pretty active in that market.

With that equity, whether the customer ends up buying a new car or not, that's a valuable asset that was very different from the situation just three years ago, when negative equity was the prevalent customer position. It's helping offset the ATPs that you might be seeing out there, that trade-in credit.

Jon: Maybe shifting gears a little bit, I think Paul spoke about EVs a bit in his presentation. For the folks who were around yesterday, there was a Hummer and a Lyriq, multiple Hummers and Lyriqs, downstairs to test drive.

With more EV models coming to market, the continued improvements we've seen in battery technology, how do you at GM Financial balance underwriting conservatively versus trying to offer a competitive rate to consumers?

Dan: You're referring to more on the lease side or on the loan side?

Jon: Probably more on the lease side, but maybe we could talk about...

Dan: On the loan side, we're underwriting, as I said, for affordability. The collateral comes into play in LTV. In our historical experience, whether it's a prime consumer or a subprime, LTV would only affect loan performance at the extremes.

In other words, if it was very low, 75 percent, let's say, LTV, you might get a lift in performance. 125, 130, that might be an area where the customer is just flat overburdened because the payment would be that much higher.

On the loan side, whether it's an ICE or an EV, collateral is important but secondary to all the other factors about income, debt ratios, employment history, etc., credit score. The lease side is really where collateral value is most important because 100 percent of the time on a lease, we ultimately could have exposure to that vehicle at the end of the lease.

As it relates to EVs or ICE, as the FinCo, our transfer pricing with GM is ALG. ALG, Automotive Lease Guide, is an independent company that determines residual values for any brand, or GM in particular here. They look at all the factors that might affect used car values three years down the road, meaning supply, demand, the economy, gas prices, any other incentive levels.

EVs don't have that much history. ICE, obviously, has a long history of aftermarket sales and residual value realizations. ALG is typically a bit more conservative on EVs than they have been on ICE for a comparable vehicle.

We have experience with the Bolt. We've been leasing Bolts now for five years, I guess, roughly and have a good degree, thousands, of returns. The conservatism of ALG has really proved out. That initial residual has proven to be low.

Our resale experience with Bolt has really been quite good compared to the ALG origination. We'd expect ALG to continue to be conservative until we get more and more history on EVs.

Jon: Good. Maybe as a follow-up to that, is it fair to think that until we have more transaction volume and better data around EV residuals, they're not going to lease as competitively as internal combustion vehicles?

Dan: I was talking from a GMF standpoint. Whether it's an ICE or an EV, the manufacturer GM always has the option to enhance the residual. For them, it's a marketing spend. If the ALG residual is conservative, GM can put money on the hood. Put money on the hood as either a rebate or a price reduction, or it could be just on a lease, enhancing the residual.

They can make a lease quite competitive if they want to. The goal at GM, GMF on EVs would be to have about the same lease penetration as an ICE vehicle. On the Lyriq, which is a luxury

vehicle, it's going to be higher just like Cadillac is higher on an ICE vehicle. On a Chevy, it's going to be lower, but we're targeting a comparable penetration.

Jon: Thank you. I guess in light of macroeconomic pressure, how do you think about and go around stress testing the portfolio scenarios? Are you modeling out in terms of charge-offs? Maybe you could also talk a little bit about your capital cushion relative to that 10 times managerial leverage target, and I think the 12 times support agreement threshold.

Dan: Like Mary said on the GM earnings call a week or two ago, we run a lot to stress test at the GMF level. At GMF, but particularly our predecessor company, AmeriCredit, we've been through quite a few downturns including '08, '09.

We run different scenarios. The most acute stresses for us would be -- no surprise -- used car price is probably the most, credit, secondary. I say secondary because our book now is quite prime. Looking back at history, prime credit gets hit, nicked a bit in a downturn but not in an absolute degree, subprime would.

That's secondary. Then, third would be cost of funds and credit spreads would be what we stress test. Then as a corollary to being the captive, unit volumes would decrease. We run different levels of stress, used car prices down 10, down 20, credit up 50 percent up a hundred percent, unit volumes down.

I would say that in even a severe stress case, our profitability would be solid. Our guidance for this year is to earn about four billion pre-tax. Even in a severe case, our profitability would still be solid. Our leverage ratio now is, as we define it, is 7.6, our managerial target is 10. We would not get close to that 10 times managerial target we have.

Our capitalization would hold up quite well. We held at the end of the second quarter, 31 billion of liquidity, which is cash and committed unused credit lines. We hold that much liquidity so that in a stress case, we can continue to support the enterprise through leasing loans, dealer finance etc.

Jon: Dan, I want to maybe follow up on one thing you mentioned there, which is in the stress case, your expectation for unit volumes would be down alongside, SOR decline. It's probably been a couple years since we went through this ourselves.

Is it right to think that the balance sheet rolls off? That if unit volumes are declining, the balance sheet naturally de-levers?

Dan: Yeah. Absolutely. That's the important aspect of the auto finance asset class, is that if you slow down originations, whether you have to or whether the industry declines, your portfolio runs off pretty quick.

We've set up our asset liability management so that as the assets run off, they run off quicker than the liabilities. We would be able to, even if the portfolio is declining, meet our obligations in a very orderly fashion and actually create liquidity and capital.

Jon: Thank you. GM and GM Financial recently finalized their Sustainable Finance Framework. We saw GM last week issue green bonds. I wanted to get your thoughts, GM Financial's appetite and capacity for green and/or sustainable debt.

Dan: As you mentioned, we're part of a joint framework with GM. They did issue. Our issuance would be supporting finance of electric or autonomous vehicles. I mentioned before that we've done a good number of Bolts. We don't have the scale or critical mass of EV in our portfolio yet to really justify a bond.

I would anticipate, as we finance more Hummers and LYRIQ and EV Silverados, that we'll get to the point where we've got the critical mass in the portfolio. We could roll out a billion-dollar green bond, for instance. I don't see that happening for the next probably 12 months. But it's clearly something that latter half of '23 into '24 we'll be active in.

Jon: Then, aside from consumer credit, residuals, the broader economy, what else is going on at GM Financial? I understand you recently launched Cadillac Financial. Maybe you could tell us a little bit about that. Then, also, any updates you can provide on the bank charter and OnStar Insurance. There's a lot in there.

Dan: Cadillac Financial, it's really a new brand for GM Financial meant to provide Cadillac dealers and consumers a concierge experience. It isn't any different than what other captive OEMs provide for their luxury customers.

I know many of the brands have a separate captive for their luxury brands. We just didn't get there simply because we had a lot on our plate growing the business from the AmeriCredit days to the full captive days at GM Financial.

It's pretty exciting. On the dealer side, we've got some of our reps trained specifically in the

Cadillac Finance products that we offer. They can provide a better level of assistance for dealers and their F&I shops to understand the product offerings we have.

On the consumer side, we've got trained customer experience reps that provide a even higher level of service, answer the phones quicker, first call resolution guaranteed. We started that in May. Our early NPS scores, customer sentiment, is much higher than the traditional customer experience, which is really quite good. The whole idea of this is to elevate the experience, to increase Cadillac customer loyalty.

Already, Jon, GM Financial has the highest loyalty rate of any captive out there. In other words, customers who financed through GM Financial are more apt to buy the brand again than any other brand, any other OEM.

Interesting, if you compare the customer who finances through a bank or credit union versus GM Financial and buys a GM product, it's magnitudes higher, their loyalty, which is one of the reasons that GM and dealers want to get the penetration to GM Financial higher on a retail basis. The loyalty aspect is really the payback for us on Cadillac Financial.

You mentioned OnStar Insurance. That was incubated within GM and was transferred to GM Financial just this calendar year. For those of you who don't know the concept, it's really to provide auto insurance product to GM customers. We think we've got a pretty good formula.

The three competitive keys in insurance are access to the customer. Of course, the big names, you see them advertised all the time. They spend billions on advertising. We think that we have access to the customer at the point of sale, especially now that there's going to be a lot of digital aspect to the sale.

They're going to go through a online funnel. They're going to take delivery at the dealer, of course. But not only GM Financial but OnStar Insurance, we can insert our marketing into that funnel. We don't have to spend marketing dollars. It's a natural access to the customer at the point of sale.

Second big aspect of insurance competitively is underwriting and data. Through the OnStar product itself, we have better data on customer-driving behavior than anything else. A normal telematics might be off of a cell phone, which is good. But OnStar captures simple things like, are you wearing your seatbelt? You can't capture that off a cell phone. OnStar can. Simple thing.

There's even things more complex, like you're driving 55. But everyone around you is driving 35. OnStar can capture that. But cell phone can't. Our data, we think, is pretty powerful in terms of ability to separate the good drivers and the bad ones and provide a right premium for the good drivers and maybe avoid the bad ones.

Then, third, our GM ecosystem is really going to allow us to provide a better claims experience, again, through OnStar. OnStar knows immediately when there's an accident and, within minutes, can assess the damage.

Whereas a normal insurance claims process might take days or weeks. We can identify, assess quickly, get them a loaner from a dealer, have the car taken to a GM body shop, and really cut weeks off that process, which is a huge pain point in insurance.

Now, we're not going to seek to outmarket the big ones or pick off their portfolio. But through point of sale, better data underwriting, and the claims experience, we think we can carve out a pretty good niche in insurance. It's a complete extension of what we do at GM Financial now in the F&I shop.

Then, Jon, you asked about the bank. It seems like forever. But we actually made that application back in December of 2020. That was 19 months ago, 20 months ago. It's been held up in the political morass of Washington.

Specifically, it has to be approved. We've gone through examination, investigation, so taken most of the heavy lifting steps. Now it has to be approved by the FDIC. The FDIC has a temporary head. The full board isn't seated. I think three of the five are seated. So it's difficult for us to move that application forward until the political situation clears up. Hard to say when that'll be.

We still believe it's a good addition to our funding platform to supplement what we do now, not replace ABS or unsecured, but really just to provide another method to fund our business.

Jon: We got a couple minutes left here. Any questions from the audience? I think we've got a microphone coming. One second.

Audience Member: Over the last few years, the residual value for EV is generally performing less than ICE.

Dan: No. Everything's relative. As I said, the origination ALG residual is typically conservative.

Given a lower bar, actual performance has been better than that lower bar.

Audience Member: Yes, understood. But they are still generally lower, like after three-year comparable vehicle. That's in the past.

Going forward, several people yesterday speaker industry, the management, they don't want to forecast residual value. It's just difficult in lease obviously setting that residual value is important. Going forward as GM and the industry will produce more EV, that's the trend. This is still relatively newer model than ICE.

I guess the question is AOG is conservative. I have respect for them. For EV, you also commented that you want the same penetration.

Dan: Of lease, yes.

Audience Member: EV, ICE. I personally think loan would be better because that takes care of residual value better. So how do you deal with this? 5 years down, 10 years, we'll all feel more comfortable. But as we go through this new territory, I'm from the lending perspective. Like to hear your thoughts.

Dan: Leasing is an important part of the sales tools for OEMs. The loyalty on a lease customer is much higher than a loan customer because you know you're going to see that customer again in three years. You know exactly when they're going to have to come back to the dealer. You've got a very good shot at getting them in another vehicle. To not use that sales tool I think would be short-sighted.

As I said, the ALG origination residual will be conservative, is being conservative. But OEMs have the ability to do a marketing spend to get that residual up from an economic standpoint so that lease is a viable alternative on EVs.

They'll do that, again, because, looking out, you want lease in your portfolio. You want to see those customers again as soon as possible.

Audience Member: But leasing has been coming down last two year because of limited supply.

Dan: It's coming down because...

Audience Member: You don't have to throw them money.

Dan: OEMs haven't had to spend the money.

Audience Member: Do you see that gradually getting better?

Dan: Yeah, I would say as supply comes back, then leasing will come back to traditional levels.

Jon: All right. We're out of time here. Thank you, Dan and the GM Financial team. Thank you all for joining us today.



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