

# CONSUMER PORTFOLIO SERVICES INC

## FORM 10-Q (Quarterly Report)

Filed 10/31/16 for the Period Ending 09/30/16

|             |   |
|-------------|---|
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| Telephone   | 9497536800                              |
| CIK         | 0000889609                              |
| Symbol      | CPSS                                    |
| SIC Code    | 6199 - Finance Services                 |
| Industry    | Consumer Lending                        |
| Sector      | Financials                              |
| Fiscal Year | 12/31                                   |

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

**FORM 10-Q**

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

**For the quarterly period ended September 30, 2016**

**Commission file number: 1-11416**

**CONSUMER PORTFOLIO SERVICES, INC.**

**(Exact name of registrant as specified in its charter)**

California  
(State or other jurisdiction of incorporation or organization)

33-0459135  
(IRS Employer Identification No.)

3800 Howard Hughes Parkway, Suite 1400,  
Las Vegas, Nevada  
(Address of principal executive offices)

89169  
(Zip Code)

**Registrant's telephone number, including Area Code: (949) 753-6800**

Former name, former address and former fiscal year, if changed since last report: N/A

Indicate by check mark whether the registrant (1) 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  No

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  No

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 definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer   
Non-Accelerated Filer  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  No

As of October 27, 2016 the registrant had 23,841,970 common shares outstanding.

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
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**For the Quarterly Period Ended September 30, 2016**

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except share and per share data)

|   | September 30,<br>2016 | December 31,<br>2015 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Cash and cash equivalents   | \$ 11,494             | \$ 19,322            |
| Restricted cash and equivalents   | 116,403               | 106,054              |
| Finance receivables   | 2,257,151             | 1,985,093            |
| Less: Allowance for finance credit losses   | (96,843)              | (75,603)             |
| Finance receivables, net  | 2,160,308             | 1,909,490            |
| Finance receivables measured at fair value  | 7                     | 61                   |
| Furniture and equipment, net  | 1,918                 | 1,715                |
| Deferred tax assets, net  | 43,197                | 37,597               |
| Accrued interest receivable   | 33,078                | 31,547               |
| Other assets  | 22,630                | 23,139               |
|   | <u>\$ 2,389,035</u>   | <u>\$ 2,128,925</u>  |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                       |                      |
| <b>Liabilities</b>  |                       |                      |
| Accounts payable and accrued expenses   | \$ 33,563             | \$ 29,509            |
| Warehouse lines of credit   | 81,683                | 194,056              |
| Residual interest financing   | 6,856                 | 9,042                |
| Securitization trust debt   | 2,073,409             | 1,720,021            |
| Subordinated renewable notes  | 14,353                | 15,138               |
|   | <u>2,209,864</u>      | <u>1,967,766</u>     |
| <b>COMMITMENTS AND CONTINGENCIES</b>  |                       |                      |
| <b>Shareholders' Equity</b>   |                       |                      |
| Preferred stock, \$1 par value; authorized 4,998,130 shares; none issued  | -                     | -                    |
| Series A preferred stock, \$1 par value; authorized 5,000,000 shares; none issued   | -                     | -                    |
| Series B preferred stock, \$1 par value; authorized 1,870 shares; none issued   | -                     | -                    |
| Common stock, no par value; authorized 75,000,000 shares; 23,765,798 and 25,616,460 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively | 77,514                | 81,337               |
| Retained earnings   | 108,307               | 86,472               |
| Accumulated other comprehensive loss  | (6,650)               | (6,650)              |
|   | <u>179,171</u>        | <u>161,159</u>       |
|   | <u>\$ 2,389,035</u>   | <u>\$ 2,128,925</u>  |

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.*

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
(In thousands, except per share data)

|   | Three Months Ended<br>September 30, |                 | Nine Months Ended<br>September 30, |                  |
|---|-------------------------------------|-----------------|------------------------------------|------------------|
|   | 2016                                | 2015            | 2016                               | 2015             |
| <b>Revenues:</b>  |                                     |                 |                                    |                  |
| Interest income   | \$ 105,376                          | \$ 90,584       | \$ 303,748                         | \$ 257,843       |
| Servicing fees  | 26                                  | 73              | 73                                 | 283              |
| Other income  | 3,114                               | 3,334           | 10,278                             | 10,215           |
|   | <u>108,516</u>                      | <u>93,991</u>   | <u>314,099</u>                     | <u>268,341</u>   |
| <b>Expenses:</b>  |                                     |                 |                                    |                  |
| Employee costs  | 16,688                              | 15,254          | 47,510                             | 42,884           |
| General and administrative                                    | 6,316                               | 5,005           | 18,216                             | 14,949           |
| Interest  | 20,893                              | 14,848          | 58,442                             | 41,709           |
| Provision for credit losses                                   | 46,262                              | 37,411          | 134,881                            | 106,533          |
| Marketing   | 4,463                               | 4,608           | 13,864                             | 13,247           |
| Occupancy   | 1,237                               | 1,046           | 3,608                              | 2,950            |
| Depreciation and amortization                                 | 202                                 | 170             | 568                                | 471              |
|   | <u>96,061</u>                       | <u>78,342</u>   | <u>277,089</u>                     | <u>222,743</u>   |
| Income before income tax expense                              | 12,455                              | 15,649          | 37,010                             | 45,598           |
| Income tax expense  | 5,107                               | 6,806           | 15,175                             | 19,885           |
| Net income  | <u>\$ 7,348</u>                     | <u>\$ 8,843</u> | <u>\$ 21,835</u>                   | <u>\$ 25,713</u> |
| <b>Earnings per share:</b>                                    |                                     |                 |                                    |                  |
| Basic   | \$ 0.31                             | \$ 0.34         | \$ 0.89                            | \$ 0.99          |
| Diluted   | 0.26                                | 0.28            | 0.75                               | 0.81             |
| <b>Number of shares used in computing earnings per share:</b> |                                     |                 |                                    |                  |
| Basic   | 23,894                              | 26,093          | 24,574                             | 25,989           |
| Diluted   | 28,503                              | 31,476          | 29,253                             | 31,796           |

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.*

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(In thousands)

|  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|----------|------------------------------------|-----------|
|  | 2016                                | 2015     | 2016                               | 2015      |
|  | Net income                          | \$ 7,348 | \$ 8,843                           | \$ 21,835 |
| Other comprehensive income/(loss); change in funded status of pension plan | —                                   | —        | —                                  | —         |
| Comprehensive income   | \$ 7,348                            | \$ 8,843 | \$ 21,835                          | \$ 25,713 |

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.*

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(In thousands)

|   | Nine Months Ended<br>September 30, |                  |
|---|------------------------------------|------------------|
|   | 2016                               | 2015             |
| <i>Cash flows from operating activities:</i>                                      |                                    |                  |
| Net income  | \$ 21,835                          | \$ 25,713        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                  |
| Accretion of deferred acquisition fees and origination costs                      | (2,686)                            | (7,345)          |
| Amortization of discount on securitization trust debt                             | 20                                 | 53               |
| Depreciation and amortization   | 568                                | 471              |
| Amortization of deferred financing costs  | 6,214                              | 5,149            |
| Provision for credit losses   | 134,881                            | 106,533          |
| Stock-based compensation expense  | 4,004                              | 3,609            |
| Interest income on residual assets  | -                                  | (85)             |
| Changes in assets and liabilities:  |                                    |                  |
| Accrued interest receivable   | (1,531)                            | (8,435)          |
| Deferred tax assets, net  | (5,600)                            | (1,326)          |
| Other assets  | (2,627)                            | 6,501            |
| Accounts payable and accrued expenses   | 4,054                              | 7,199            |
| Net cash provided by operating activities   | <u>159,132</u>                     | <u>138,037</u>   |
| <i>Cash flows from investing activities:</i>                                      |                                    |                  |
| Purchases of finance receivables held for investment                              | (873,499)                          | (791,335)        |
| Payments received on finance receivables held for investment                      | 490,486                            | 403,246          |
| Payments received on receivables portfolio at fair value                          | 54                                 | 1,529            |
| Change in repossessions held in inventory   | 3,136                              | 289              |
| Change in restricted cash and cash equivalents, net                               | (10,349)                           | (31,244)         |
| Purchase of furniture and equipment   | (771)                              | (1,029)          |
| Net cash used in investing activities   | <u>(390,943)</u>                   | <u>(418,544)</u> |
| <i>Cash flows from financing activities:</i>                                      |                                    |                  |
| Proceeds from issuance of securitization trust debt                               | 980,650                            | 795,000          |
| Proceeds from issuance of subordinated renewable notes                            | 1,303                              | 1,153            |
| Payments on subordinated renewable notes  | (2,088)                            | (1,194)          |
| Net repayments of warehouse lines of credit                                       | (112,725)                          | (9,905)          |
| Repayments of residual interest financing debt                                    | (2,186)                            | (1,755)          |
| Repayment of securitization trust debt  | (625,499)                          | (489,971)        |
| Repayment of debt secured by receivables measured at fair value                   | -                                  | (1,250)          |
| Payment of financing costs  | (7,645)                            | (7,199)          |
| Purchase of common stock  | (8,013)                            | (2,846)          |
| Exercise of options and warrants  | 186                                | 1,530            |
| Net cash provided by financing activities   | <u>223,983</u>                     | <u>283,563</u>   |
| Increase (decrease) in cash and cash equivalents                                  | (7,828)                            | 3,056            |
| Cash and cash equivalents at beginning of period                                  | 19,322                             | 17,859           |
| Cash and cash equivalents at end of period  | <u>\$ 11,494</u>                   | <u>\$ 20,915</u> |
| <i>Supplemental disclosure of cash flow information:</i>                          |                                    |                  |
| Cash paid during the period for:  |                                    |                  |
| Interest  | \$ 36,372                          | \$ 33,915        |
| Income taxes  | \$ 16,900                          | \$ 13,690        |

*See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.*

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Summary of Significant Accounting Policies**

**Description of Business**

We were formed in California on March 8, 1991. We specialize in purchasing and servicing retail automobile installment sale contracts (“automobile contracts” or “finance receivables”) originated by licensed motor vehicle dealers located throughout the United States (“dealers”) in the sale of new and used automobiles, light trucks and passenger vans. Through our purchases, we provide indirect financing to dealer customers for borrowers with limited credit histories or past credit problems (“sub-prime customers”). We serve as an alternative source of financing for dealers, allowing sales to customers who otherwise might not be able to obtain financing. In addition to purchasing installment purchase contracts directly from dealers, we have also (i) acquired installment purchase contracts in four merger and acquisition transactions, (ii) purchased immaterial amounts of vehicle purchase money loans from non-affiliated lenders, and (iii) lent money directly to consumers for an immaterial amount of loans secured by vehicles. In this report, we refer to all of such contracts and loans as “automobile contracts.”

**Basis of Presentation**

Our Unaudited Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America, with the instructions to Form 10-Q and with Article 10 of Regulation S-X of the Securities and Exchange Commission, and include all adjustments that are, in management’s opinion, necessary for a fair presentation of the results for the interim periods presented. All such adjustments are, in the opinion of management, of a normal recurring nature. Results for the nine month period ended September 30, 2016 are not necessarily indicative of the operating results to be expected for the full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted from these Unaudited Condensed Consolidated Financial Statements. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2015.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of income and expenses during the reported periods.

**Other Income**

The following table presents the primary components of Other Income for the three-month and nine-month periods ending September 30, 2016 and 2015:

|  | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                  |
|--|---------------------------|-----------------|--------------------------|------------------|
|  | <b>September 30,</b>      |                 | <b>September 30,</b>     |                  |
|  | <b>2016</b>               | <b>2015</b>     | <b>2016</b>              | <b>2015</b>      |
|  | <b>(In thousands)</b>     |                 | <b>(In thousands)</b>    |                  |
| Direct mail revenues                           | \$ 2,080                  | \$ 2,416        | \$ 7,302                 | \$ 6,935         |
| Convenience fee revenue                        | 520                       | 580             | 1,625                    | 2,060            |
| Recoveries on previously charged-off contracts | 268                       | 167             | 634                      | 666              |
| Sales tax refunds                              | 204                       | 138             | 605                      | 432              |
| Other  | 42                        | 33              | 112                      | 122              |
| Other income for the period                    | <u>\$ 3,114</u>           | <u>\$ 3,334</u> | <u>\$ 10,278</u>         | <u>\$ 10,215</u> |

**Warrants**

In connection with the amendment to and partial repayment of our residual interest financing in July 2008, we issued warrants exercisable for 2,500,000 common shares for \$4,071,429. The warrants represent the right to purchase 2,500,000 CPS common shares at a nominal exercise price, at any time prior to July 10, 2018. In March 2010 we repurchased warrants for 500,000 of these shares for \$1.0 million. Warrants to purchase 2,000,000 shares remain outstanding as of September 30, 2016.

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Stock-based Compensation**

We recognize compensation costs in the financial statements for all share-based payments based on the grant date fair value estimated in accordance with the provisions of ASC 718 “Stock Compensation”.

For the three and nine months ended September 30, 2016, we recorded stock-based compensation costs in the amount of \$1.4 million and \$4.0 million, respectively. These stock-based compensation costs were \$1.4 million and \$3.6 million for the three and nine months ended September 30, 2015. As of September 30, 2016, unrecognized stock-based compensation costs to be recognized over future periods equaled \$11.5 million. This amount will be recognized as expense over a weighted-average period of 2.3 years.

The following represents stock option activity for the nine months ended September 30, 2016:

|  | Number of<br>Shares<br>(in thousands) | Weighted<br>Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term |
|--|---------------------------------------|---------------------------------------|---|
| Options outstanding at the beginning of period | 11,228                                | \$ 4.66                               | 5.55 years  |
| Granted  | 2,015                                 | 3.48                                  |   |
| Exercised                                      | (127)                                 | 1.22                                  |   |
| Forfeited                                      | (155)                                 | —                                     |   |
| Options outstanding at the end of period       | <u>12,961</u>                         | <u>\$ 4.50</u>                        | 5.10 years  |
| Options exercisable at the end of period       | <u>7,646</u>                          | <u>\$ 3.98</u>                        | 4.47 years  |

At September 30, 2016, the aggregate intrinsic value of options outstanding and exercisable was \$10.8 million and \$9.6 million, respectively. There were 127,350 options exercised for the nine months ended September 30, 2016 compared to 1,033,000 for the comparable period in 2015. The total intrinsic value of options exercised was \$379,000 and \$7.1 million for the nine-month periods ended September 30, 2016 and 2015. There were 3.6 million shares available for future stock option grants under existing plans as of September 30, 2016.

**Purchases of Company Stock**

During the nine-month period ended September 30, 2016, we purchased 2.0 million shares of our stock in the open market at an average price of \$4.05.

During the nine-month period ended September 30, 2015, we purchased 545,521 shares of our common stock, at an average price of \$6.21. We purchased 468,948 shares of our stock in the open market at an average price of \$6.07. The remaining purchases of 75,573 shares were related to net exercises of outstanding options and warrants. In transactions during the nine-month period ended September 30, 2015, the holders of options and warrants to purchase 392,200 shares of our common stock paid the aggregate \$535,000 exercise price by surrender to us of 75,573 of such 392,200 shares.

**Reclassifications**

Some items in the prior year financial statements were reclassified to conform to the current presentation. Reclassifications had no effect on prior year net income or total shareholders’ equity.

**Financial Covenants**

Certain of our securitization transactions, our warehouse credit facilities and our residual interest financing contain various financial covenants requiring minimum financial ratios and results. Such covenants include maintaining minimum levels of liquidity and net worth and not exceeding maximum leverage levels. As of September 30, 2016, we were in compliance with all such covenants. In addition, certain of our debt agreements other than our term securitizations contain cross-default provisions. Such cross-default provisions would allow the respective creditors to declare a default if an event of default occurred with respect to other indebtedness of ours, but only if such other event of default were to be accompanied by acceleration of such other indebtedness.

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Provision for Contingent Liabilities**

We are routinely involved in various legal proceedings resulting from our consumer finance activities and practices, both continuing and discontinued. Our legal counsel has advised us on such matters where, based on information available at the time of this report, there is an indication that it is both probable that a liability has been incurred and the amount of the loss can be reasonably determined.

We have recorded a liability as of September 30, 2016, which represents our best estimate of probable incurred losses for legal contingencies. The amount of losses that may ultimately be incurred cannot be estimated with certainty.

**New Accounting Pronouncements**

In August 2016, the FASB issued Accounting Standards Update ("ASU") 2016-15 - Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. ASU 2016-15 provides cash flow statement classification guidance for certain transactions including how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years and should be applied retrospectively. Early adoption is permitted, including adoption in an interim period. The Company is assessing ASU 2016-15 but does not expect a significant impact on its accounting and disclosures.

In June 2016, the FASB issued Accounting Standards Update ("ASU") 2016-13 - Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. The revised accounting guidance will remove all recognition thresholds and will require a company to recognize an allowance for credit losses for the difference between the amortized cost basis of a financial instrument and the amount of amortized cost that the company expects to collect over the instrument's contractual life. It also amends the credit loss measurement guidance for beneficial interests in securitized financial assets. This new accounting guidance will be effective for interim and annual reporting periods beginning after December 15, 2019. The Company is currently evaluating the provisions of ASU No. 2016-13 to determine the potential impact the new standard will have on the Company's Consolidated Financial Statements.

**(2) Finance Receivables**

Our portfolio of finance receivables consists of small-balance homogeneous contracts comprising a single segment and class that is collectively evaluated for impairment on a portfolio basis according to delinquency status. Our contract purchase guidelines are designed to produce a homogenous portfolio. For key terms such as interest rate, length of contract, monthly payment and amount financed, there is relatively little variation from the average for the portfolio. We report delinquency on a contractual basis. Once a contract becomes greater than 90 days delinquent, we do not recognize additional interest income until the obligor under the contract makes sufficient payments to be less than 90 days delinquent. Any payments received on a contract that is greater than 90 days delinquent are first applied to accrued interest and then to principal reduction.

The following table presents the components of Finance Receivables, net of unearned interest:

|  | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|-------------------------------|------------------------------|
| <b>(In thousands)</b>                                    |                               |                              |
| Finance Receivables                                      |                               |                              |
| Automobile finance receivables, net of unearned interest | \$ 2,256,894                  | \$ 1,990,913                 |
| Unearned acquisition fees and originations costs         | 257                           | (5,820)                      |
| Finance Receivables                                      | <u>\$ 2,257,151</u>           | <u>\$ 1,985,093</u>          |

We consider an automobile contract delinquent when an obligor fails to make at least 90% of a contractually due payment by the following due date, which date may have been extended within limits specified in the servicing agreements. The period of delinquency is based on the number of days payments are contractually past due, as extended where applicable. Automobile contracts less than 31 days delinquent are not included. In certain circumstances we will grant obligors one-month payment extensions to assist them with temporary cash flow problems. The only modification of terms is to advance the obligor's next due date by one month and extend the maturity date of the receivable by one month. In certain limited cases, a two-month extension may be granted. There are no other concessions such as a reduction in interest rate, forgiveness of principal or of accrued interest. Accordingly, we consider such extensions to be insignificant delays in payments rather than troubled debt restructurings. The following table summarizes the delinquency status of finance receivables as of September 30, 2016 and December 31, 2015:

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

|                    | <b>September 30,</b>  | <b>December 31,</b> |
|--------------------|-----------------------|---------------------|
|                    | <b>2016</b>           | <b>2015</b>         |
|                    | <b>(In thousands)</b> |                     |
| Delinquency Status |                       |                     |
| Current            | \$ 2,051,087          | \$ 1,836,267        |
| 31 - 60 days       | 119,283               | 70,036              |
| 61 - 90 days       | 50,248                | 41,136              |
| 91 + days          | 36,276                | 43,474              |
|                    | \$ 2,256,894          | \$ 1,990,913        |

Finance receivables totaling \$36.3 million and \$43.5 million at September 30, 2016 and December 31, 2015, respectively, including all receivables greater than 90 days delinquent, have been placed on non-accrual status as a result of their delinquency status.

We use a loss allowance methodology commonly referred to as "static pooling," which stratifies our finance receivable portfolio into separately identified pools based on the period of origination. Using analytical and formula driven techniques, we estimate an allowance for finance credit losses, which we believe is adequate for probable incurred credit losses that can be reasonably estimated in our portfolio of automobile contracts. The estimate for probable incurred credit losses is reduced by our estimate for future recoveries on previously incurred losses. Provision for losses is charged to our consolidated statement of operations. Net losses incurred on finance receivables are charged to the allowance. We establish the allowance for new receivables over the 12-month period following their acquisition.

The following table presents a summary of the activity for the allowance for finance credit losses for the three-month and nine-month periods ended September 30, 2016 and 2015:

|                                | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
|                                | <b>(In thousands)</b>     |             | <b>(In thousands)</b>    |             |
| Balance at beginning of period | \$ 90,168                 | \$ 74,541   | \$ 75,603                | \$ 61,460   |
| Provision for credit losses on |                           |             |                          |             |
| finance receivables            | 46,262                    | 37,411      | 134,881                  | 106,533     |
| Charge-offs                    | (46,839)                  | (38,608)    | (134,674)                | (105,273)   |
| Recoveries                     | 7,252                     | 5,415       | 21,033                   | 16,039      |
| Balance at end of period       | \$ 96,843                 | \$ 78,759   | \$ 96,843                | \$ 78,759   |

Excluded from finance receivables are contracts that were previously classified as finance receivables but were reclassified as other assets because we have repossessed the vehicle securing the Contract. The following table presents a summary of such repossessed inventory together with the allowance for losses in repossessed inventory that is not included in the allowance for finance credit losses:

|  | <b>September 30,</b>  | <b>December 31,</b> |
|--|-----------------------|---------------------|
|  | <b>2016</b>           | <b>2015</b>         |
|  | <b>(In thousands)</b> |                     |
| Gross balance of repossessions in inventory        | \$ 33,781             | \$ 39,728           |
| Allowance for losses on repossessed inventory      | (24,143)              | (26,954)            |
| Net repossessed inventory included in other assets | \$ 9,638              | \$ 12,774           |

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**3) Securitization Trust Debt**

We have completed many securitization transactions that are structured as secured borrowings for financial accounting purposes. The debt issued in these transactions is shown on our Unaudited Condensed Consolidated Balance Sheets as “Securitization trust debt,” and the components of such debt are summarized in the following table:

| Series                 | Final Scheduled Payment Date (1) | Receivables Pledged at September 30, 2016 (2) | Initial Principal   | Outstanding Principal at September 30, 2016 | Outstanding Principal at December 31, 2015 | Weighted Average Contractual Interest Rate at September 30, 2016 |
|------------------------|----------------------------------|---|---------------------|---|--|--|
| (Dollars in thousands) |                                  |   |                     |   |  |  |
| CPS 2011-B             | September 2018                   | \$ —  | \$ 109,936          | \$ —  | \$ 10,023                                  | —  |
| CPS 2011-C             | March 2019                       | —   | 119,400             | —   | 14,785                                     | —  |
| CPS 2012-A             | June 2019                        | —   | 155,000             | —   | 16,795                                     | —  |
| CPS 2012-B             | September 2019                   | 15,515  | 141,500             | 14,918                                      | 26,758                                     | 3.12%  |
| CPS 2012-C             | December 2019                    | 18,088  | 147,000             | 17,616                                      | 30,653                                     | 2.42%  |
| CPS 2012-D             | March 2020                       | 22,993  | 160,000             | 21,925                                      | 37,464                                     | 1.88%  |
| CPS 2013-A             | June 2020                        | 35,972  | 185,000             | 34,612                                      | 56,583                                     | 1.75%  |
| CPS 2013-B             | September 2020                   | 46,858  | 205,000             | 44,329                                      | 70,332                                     | 2.23%  |
| CPS 2013-C             | December 2020                    | 55,188  | 205,000             | 54,212                                      | 82,851                                     | 4.37%  |
| CPS 2013-D             | March 2021                       | 55,371  | 183,000             | 53,924                                      | 82,337                                     | 3.75%  |
| CPS 2014-A             | June 2021                        | 64,327  | 180,000             | 62,490                                      | 92,571                                     | 3.31%  |
| CPS 2014-B             | September 2021                   | 84,990  | 202,500             | 84,231                                      | 121,515                                    | 2.70%  |
| CPS 2014-C             | December 2021                    | 131,011                                       | 273,000             | 130,485                                     | 183,802                                    | 2.86%  |
| CPS 2014-D             | March 2022                       | 142,752                                       | 267,500             | 141,862                                     | 198,533                                    | 3.08%  |
| CPS 2015-A             | June 2022                        | 149,850                                       | 245,000             | 148,903                                     | 201,527                                    | 2.82%  |
| CPS 2015-B             | September 2022                   | 170,369                                       | 250,000             | 169,038                                     | 221,587                                    | 2.86%  |
| CPS 2015-C             | December 2022                    | 229,347                                       | 300,000             | 226,754                                     | 283,482                                    | 3.26%  |
| CPS 2016-A             | March 2023                       | 288,216                                       | 329,460             | 273,762                                     | —  | 3.49%  |
| CPS 2016-B             | June 2023                        | 315,174                                       | 332,690             | 302,687                                     | —  | 3.69%  |
| CPS 2016-C             | September 2023                   | 312,077                                       | 318,500             | 305,021                                     | —  | 3.25%  |
|                        |                                  | <u>\$ 2,138,098</u>                           | <u>\$ 4,309,486</u> | <u>\$ 2,086,769</u>                         | <u>\$ 1,731,598</u>                        |  |

(1) The Final Scheduled Payment Date represents final legal maturity of the securitization trust debt. Securitization trust debt is expected to become due and to be paid prior to those dates, based on amortization of the finance receivables pledged to the trusts. Expected payments, which will depend on the performance of such receivables, as to which there can be no assurance, are \$217.2 million in 2016, \$770.2 million in 2017, \$536.4 million in 2018, \$320.2 million in 2019, \$171.1 million in 2020, \$54.9 million in 2021 and 3.4 million in 2022.

(2) Includes repossessed assets that are included in Other assets on our Unaudited Condensed Consolidated Balance Sheet.

Debt issuance costs of \$13.4 million and \$11.6 million as of September 30, 2016 and December 31, 2015, respectively, have been excluded from the table above. These debt issuance costs are presented as a direct deduction to the carrying amount of the Securitization trust debt on our Unaudited Condensed Consolidated Balance Sheets.

All of the securitization trust debt was sold in private placement transactions to qualified institutional buyers. The debt was issued through our wholly-owned bankruptcy remote subsidiaries and is secured by the assets of such subsidiaries, but not by our other assets.

The terms of the securitization agreements related to the issuance of the securitization trust debt and the warehouse credit facilities require that we meet certain delinquency and credit loss criteria with respect to the pool of receivables, and certain of the agreements require that we maintain minimum levels of liquidity and not exceed maximum leverage levels. As of September 30, 2016, we were in compliance with all such covenants.

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We are responsible for the administration and collection of the automobile contracts. The securitization agreements also require certain funds be held in restricted cash accounts to provide additional collateral for the borrowings, to be applied to make payments on the securitization trust debt or as pre-funding proceeds from a term securitization prior to the purchase of additional collateral. As of September 30, 2016, restricted cash under the various agreements totaled approximately \$116.4 million. Interest expense on the securitization trust debt consists of the stated rate of interest plus amortization of additional costs of borrowing. Additional costs of borrowing include facility fees, amortization of deferred financing costs and discounts on notes sold. Deferred financing costs and discounts on notes sold related to the securitization trust debt are amortized using a level yield method. Accordingly, the effective cost of the securitization trust debt is greater than the contractual rate of interest disclosed above.

Our wholly-owned bankruptcy remote subsidiaries were formed to facilitate the above asset-backed financing transactions. Similar bankruptcy remote subsidiaries issue the debt outstanding under our credit facilities. Bankruptcy remote refers to a legal structure in which it is expected that the applicable entity would not be included in any bankruptcy filing by its parent or affiliates. All of the assets of these subsidiaries have been pledged as collateral for the related debt. All such transactions, treated as secured financings for accounting and tax purposes, are treated as sales for all other purposes, including legal and bankruptcy purposes. None of the assets of these subsidiaries are available to pay other creditors.

**(4) Debt**

The terms and amounts of our other debt outstanding at September 30, 2016 and December 31, 2015 are summarized below:

| Description                  | Interest Rate   | Maturity  | Amount Outstanding at |                      |
|------------------------------|---|---|-----------------------|----------------------|
|                              |   |   | September 30,<br>2016 | December 31,<br>2015 |
| (In thousands)               |   |   |                       |                      |
| Warehouse lines of credit    | 5.50% over one month Libor<br>(Minimum 6.50%)   | April 2019  | \$ 56,197             | \$ 91,504            |
|                              | 5.50% over one month Libor<br>(Minimum 6.25%)   | August 2019   | 14,539                | 73,940               |
|                              | 6.75% over a commercial<br>paper rate (Minimum 7.75%)   | November 2019   | 13,000                | 31,017               |
| Residual interest financing  | 11.75% over one month Libor   | April 2018  | 6,856                 | 9,042                |
| Subordinated renewable notes | Weighted average rate of<br>8.01% and 9.04% at<br>September 30, 2016 and<br>December 31, 2015 ,<br>respectively | Weighted average maturity<br>of July 2018 and October<br>2017 at September 30, 2016<br>and December 31, 2015,<br>respectively | 14,353                | 15,138               |
|                              |   |   | \$ 104,945            | \$ 220,641           |

Debt issuance costs of \$2.1 million and \$2.4 million as of September 30, 2016 and December 31, 2015, respectively, have been excluded from the table above. These debt issuance costs are presented as a direct deduction to the carrying amount of the Warehouse lines of credit on our Unaudited Condensed Consolidated Balance Sheets.

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**(5) Interest Income and Interest Expense**

The following table presents the components of interest income:

|                                 | <b>Three Months Ended<br/>September 30,</b> |                  | <b>Nine Months Ended<br/>September 30,</b> |                   |
|---------------------------------|---|------------------|--|-------------------|
|                                 | <b>2016</b>                                 | <b>2015</b>      | <b>2016</b>                                | <b>2015</b>       |
|                                 | <b>(In thousands)</b>                       |                  | <b>(In thousands)</b>                      |                   |
| Interest on finance receivables | \$ 105,296                                  | \$ 90,564        | \$ 303,548                                 | \$ 257,757        |
| Residual interest income        | –   | 20               | –  | 85                |
| Other interest income           | 80  | –                | 200  | 1                 |
| Interest income                 | <u>\$ 105,376</u>                           | <u>\$ 90,584</u> | <u>\$ 303,748</u>                          | <u>\$ 257,843</u> |

The following table presents the components of interest expense:

|                              | <b>Three Months Ended<br/>September 30,</b> |                  | <b>Nine Months Ended<br/>September 30,</b> |                  |
|------------------------------|---|------------------|--|------------------|
|                              | <b>2016</b>                                 | <b>2015</b>      | <b>2016</b>                                | <b>2015</b>      |
|                              | <b>(In thousands)</b>                       |                  | <b>(In thousands)</b>                      |                  |
| Securitization trust debt    | \$ 18,228                                   | \$ 12,466        | \$ 49,867                                  | \$ 35,012        |
| Warehouse lines of credit    | 2,111                                       | 1,644            | 6,777                                      | 4,376            |
| Residual interest financing  | 227   | 338              | 744  | 1,111            |
| Subordinated renewable notes | 327   | 400              | 1,054                                      | 1,210            |
| Interest expense             | <u>\$ 20,893</u>                            | <u>\$ 14,848</u> | <u>\$ 58,442</u>                           | <u>\$ 41,709</u> |

**(6) Earnings Per Share**

Earnings per share for the three-month and nine-month periods ended September 30, 2016 and 2015 were calculated using the weighted average number of shares outstanding for the related period. The following table reconciles the number of shares used in the computations of basic and diluted earnings per share for the three-month and nine-month periods ended September 30, 2016 and 2015:

|   | <b>Three Months Ended<br/>September 30,</b> |               | <b>Nine Months Ended<br/>September 30,</b> |               |
|---|---|---------------|--|---------------|
|   | <b>2016</b>                                 | <b>2015</b>   | <b>2016</b>                                | <b>2015</b>   |
|   | <b>(In thousands)</b>                       |               | <b>(In thousands)</b>                      |               |
| Weighted average number of common shares outstanding during the period used to compute basic earnings per share | 23,894                                      | 26,093        | 24,574                                     | 25,989        |
| Incremental common shares attributable to exercise of outstanding options and warrants                          | <u>4,609</u>                                | <u>5,383</u>  | <u>4,679</u>                               | <u>5,807</u>  |
| Weighted average number of common shares used to compute diluted earnings per share                             | <u>28,503</u>                               | <u>31,476</u> | <u>29,253</u>                              | <u>31,796</u> |

If the anti-dilutive effects of common stock equivalents were considered, shares included in the diluted earnings per share calculation for the three-month and nine-month periods ended September 30, 2016 would have included an additional 8.6 million and 7.7 million shares, respectively attributable to the exercise of outstanding options and warrants. For the three-month and nine-month periods ended September 30, 2015, an additional 6.7 million and 5.8 million shares, respectively, would be included in the diluted earnings per share calculation.

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**(7) Income Taxes**

We file numerous consolidated and separate income tax returns with the United States and with many states. With few exceptions, we are no longer subject to U.S. federal, state, or local examinations by tax authorities for years before 2012.

As of September 30, 2016 and December 31, 2015, we had no unrecognized tax benefits for uncertain tax positions. We do not anticipate that total unrecognized tax benefits will significantly change due to any settlements of audits or expirations of statutes of limitations over the next 12 months.

The Company and its subsidiaries file a consolidated federal income tax return and combined or stand-alone state franchise tax returns for certain states. We utilize the asset and liability method of accounting for income taxes, under which deferred income taxes are recognized for the future tax consequences attributable to the differences between the financial statement values of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred taxes of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. A valuation allowance is recognized for a deferred tax asset if, based on the weight of the available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. In making such judgments, significant weight is given to evidence that can be objectively verified. Although realization is not assured, we believe that the realization of the recognized net deferred tax asset of \$43.2 million as of September 30, 2016 is more likely than not based on forecasted future net earnings. Our net deferred tax asset of \$43.2 million consists of approximately \$34.8 million of net U.S. federal deferred tax assets and \$8.4 million of net state deferred tax assets.

Income tax expense was \$5.1 million and \$15.2 million for the three months and nine months ended September 30, 2016 and represents an effective income tax rate of 41%, compared to income tax expense of \$6.8 million and \$19.9 million for the three and nine months ended September 30, 2015, and represents an effective income tax rate of 43% and 44%, respectively.

**(8) Legal Proceedings**

*Consumer Litigation.* We are routinely involved in various legal proceedings resulting from our consumer finance activities and practices, both continuing and discontinued. Consumers can and do initiate lawsuits against us alleging violations of law applicable to collection of receivables, and such lawsuits sometimes allege that resolution as a class action is appropriate.

We are currently subject to one such class action, which has been settled by agreement with the plaintiffs. The settlement remains subject to final court approval. The court has approved the settlement, but an objecting member of the settlement class took an appeal of that approval. The appeal was denied on October 18, 2016, and we expect the settlement to proceed as previously agreed.

For the most part, we have legal and factual defenses to consumer claims, which we routinely contest or settle (for immaterial amounts) depending on the particular circumstances of each case. We have recorded a liability as of September 30, 2016 with respect to such matters, in the aggregate.

*Department of Justice Subpoena.* In January 2015, we were served with a subpoena by the U.S. Department of Justice directing us to produce certain documents relating to our and our subsidiaries' and affiliates' origination and securitization of sub-prime automobile contracts since 2005, in connection with an investigation by the U.S. Department of Justice in contemplation of a civil proceeding for potential violations of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. We are among several other securitizers of sub-prime automobile receivables who received such subpoenas in 2014 and 2015. Among other matters, the subpoena required information relating to the underwriting criteria used to originate these automobile contracts and the representations and warranties relating to those underwriting criteria that were made in connection with the securitization of the automobile contracts. We provided responsive documents in March 2015, provided additional documents on September 30, 2016, and are unaware of any subsequent material developments in the government's investigation, other than its initiation. The investigation could in the future result in the imposition of damages, fines or civil or criminal claims and/or penalties. No assurance can be given as to the ultimate outcome of the investigation or any resulting proceeding(s), which might materially and adversely affect us.

*In General.* There can be no assurance as to the outcomes of the matters referenced above. We have recorded a liability as of September 30, 2016, which represents our best estimate of probable incurred losses for legal contingencies, including all of the matters described or referenced above. The amount of losses that may ultimately be incurred cannot be estimated with certainty. However, based on such information as is available to us, we believe that the range of reasonably possible losses for the legal proceedings and contingencies we face, including those described or referenced above, as of September 30, 2016, and in excess of the liability we have recorded, is from \$0 to \$250,000.

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Accordingly, we believe that the ultimate resolution of such legal proceedings and contingencies, after taking into account our current litigation reserves, should not have a material adverse effect on our consolidated financial condition. We note, however, that in light of the uncertainties inherent in contested proceedings, the wide discretion vested in the U.S. Department of Justice and other government agencies, and the deference that courts may give to assertions made by government litigants, there can be no assurance that the ultimate resolution of these matters will not significantly exceed the reserves we have accrued; as a result, the outcome of a particular matter may be material to our operating results for a particular period, depending on, among other factors, the size of the loss or liability imposed and the level of our income for that period.

**(9) Employee Benefits**

On March 8, 2002 we acquired MFN Financial Corporation and its subsidiaries in a merger. We sponsor the MFN Financial Corporation Benefit Plan (the "Plan"). Plan benefits were frozen June 30, 2001. The table below sets forth the Plan's net periodic benefit cost for the three-month and nine-month periods ended September 30, 2016 and 2015.

|  | <b>Three Months Ended</b> |                | <b>Nine Months Ended</b> |                 |
|--|---------------------------|----------------|--------------------------|-----------------|
|  | <b>September 30,</b>      |                | <b>September 30,</b>     |                 |
|  | <b>2016</b>               | <b>2015</b>    | <b>2016</b>              | <b>2015</b>     |
|  | <b>(In thousands)</b>     |                | <b>(In thousands)</b>    |                 |
| <b>Components of net periodic cost (benefit)</b> |                           |                |                          |                 |
| Service cost                                     | \$ —                      | \$ —           | \$ —                     | \$ —            |
| Interest cost                                    | 221                       | 211            | 663                      | 633             |
| Expected return on assets                        | (300)                     | (377)          | (900)                    | (1,131)         |
| Amortization of transition (asset)/obligation    | —                         | —              | —                        | —               |
| Amortization of net (gain) / loss                | 138                       | 87             | 414                      | 261             |
| Net periodic cost (benefit)                      | <u>\$ 59</u>              | <u>\$ (79)</u> | <u>\$ 177</u>            | <u>\$ (237)</u> |

We did not make any contributions to the Plan during the nine-month periods ended September 30, 2016 and 2015. We do not anticipate making any contributions for the remainder of 2016.

**(10) Fair Value Measurements**

ASC 820, "Fair Value Measurements" clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy.

ASC 820 defines fair value, establishes a framework for measuring fair value, establishes a three-level valuation hierarchy for disclosure of fair value measurement and enhances disclosure requirements for fair value measurements. The three levels are defined as follows: level 1 - inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets; level 2 - inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument; and level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Repossessed vehicle inventory, which is included in Other assets on our unaudited condensed consolidated balance sheet, is measured at fair value using level 2 assumptions based on our actual loss experience on sale of repossessed vehicles. At September 30, 2016 the finance receivables related to the repossessed vehicles in inventory totaled \$33.8 million. We have applied a valuation adjustment, or loss allowance, of \$24.1 million, which is based on a recovery rate of approximately 29%, resulting in an estimated fair value and carrying amount of \$9.6 million. The fair value and carrying amount of the repossessed inventory at December 31, 2015 was \$12.8 million after applying a valuation adjustment of \$27.0 million.

There were no transfers in or out of level 1 or level 2 assets and liabilities for the nine months ended September 30, 2016 and 2015. We have no material level 3 assets that are measured at fair value on a non-recurring basis.

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The estimated fair values of financial assets and liabilities at September 30, 2016 and December 31, 2015, were as follows

| Financial Instrument                       | As of September 30, 2016 |                                |         |           |           |
|--|--------------------------|--------------------------------|---------|-----------|-----------|
|  | (In thousands)           |                                |         |           |           |
|  | Carrying Value           | Fair Value Measurements Using: |         |           | Total     |
|  | Level 1                  | Level 2                        | Level 3 |           |           |
| <b>Assets:</b>                             |                          |                                |         |           |           |
| Cash and cash equivalents                  | \$ 11,494                | \$ 11,494                      | \$ –    | \$ –      | \$ 11,494 |
| Restricted cash and equivalents            | 116,403                  | 116,403                        | –       | –         | 116,403   |
| Finance receivables, net                   | 2,160,308                | –                              | –       | 2,105,195 | 2,105,195 |
| Finance receivables measured at fair value | 7                        | –                              | –       | 7         | 7         |
| Accrued interest receivable                | 33,078                   | –                              | –       | 33,078    | 33,078    |
| <b>Liabilities:</b>                        |                          |                                |         |           |           |
| Warehouse lines of credit                  | \$ 81,683                | \$ –                           | \$ –    | \$ 81,683 | \$ 81,683 |
| Accrued interest payable                   | 3,684                    | –                              | –       | 3,684     | 3,684     |
| Residual interest financing                | 6,856                    | –                              | –       | 6,856     | 6,856     |
| Securitization trust debt                  | 2,073,409                | –                              | –       | 2,125,859 | 2,125,859 |
| Subordinated renewable notes               | 14,353                   | –                              | –       | 14,353    | 14,353    |

| Financial Instrument                       | As of December 31, 2015 |                                |         |            |            |
|--|-------------------------|--------------------------------|---------|------------|------------|
|  | (In thousands)          |                                |         |            |            |
|  | Carrying Value          | Fair Value Measurements Using: |         |            | Total      |
|  | Level 1                 | Level 2                        | Level 3 |            |            |
| <b>Assets:</b>                             |                         |                                |         |            |            |
| Cash and cash equivalents                  | \$ 19,322               | \$ 19,322                      | \$ –    | \$ –       | \$ 19,322  |
| Restricted cash and equivalents            | 106,054                 | 106,054                        | –       | –          | 106,054    |
| Finance receivables, net                   | 1,909,490               | –                              | –       | 1,879,510  | 1,879,510  |
| Finance receivables measured at fair value | 61                      | –                              | –       | 61         | 61         |
| Accrued interest receivable                | 31,547                  | –                              | –       | 31,547     | 31,547     |
| <b>Liabilities:</b>                        |                         |                                |         |            |            |
| Warehouse lines of credit                  | \$ 194,056              | \$ –                           | \$ –    | \$ 194,056 | \$ 194,056 |
| Accrued interest payable                   | 3,260                   | –                              | –       | 3,260      | 3,260      |
| Residual interest financing                | 9,042                   | –                              | –       | 9,042      | 9,042      |
| Securitization trust debt                  | 1,720,021               | –                              | –       | 1,718,418  | 1,718,418  |
| Subordinated renewable notes               | 15,138                  | –                              | –       | 15,138     | 15,138     |

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The following summary presents a description of the methodologies and assumptions used to estimate the fair value of our financial instruments. Much of the information used to determine fair value is highly subjective. When applicable, readily available market information has been utilized. However, for a significant portion of our financial instruments, active markets do not exist. Therefore, significant elements of judgment were required in estimating fair value for certain items. The subjective factors include, among other things, the estimated timing and amount of cash flows, risk characteristics, credit quality and interest rates, all of which are subject to change. Since the fair value is estimated as of September 30, 2016 and December 31, 2015, the amounts that will actually be realized or paid at settlement or maturity of the instruments could be significantly different.

*Cash, Cash Equivalents and Restricted Cash and Equivalents*

The carrying value equals fair value.

*Finance Receivables, net*

The fair value of finance receivables is estimated by discounting future cash flows expected to be collected using current rates at which similar receivables could be originated.

*Finance Receivables Measured at Fair Value*

The carrying value equals fair value.

*Accrued Interest Receivable and Payable*

The carrying value approximates fair value.

*Warehouse Lines of Credit, Residual Interest Financing, and Subordinated Renewable Notes*

The carrying value approximates fair value because the related interest rates are estimated to reflect current market conditions for similar types of secured instruments.

*Securitization Trust Debt*

The fair value is estimated by discounting future cash flows using interest rates that we believe reflect the current market rates.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We are a specialty finance company focused on consumers who have limited credit histories or past credit problems, whom we refer to as sub-prime customers. Our business is to purchase and service retail automobile contracts originated primarily by franchised automobile dealers and, to a lesser extent, by select independent dealers in the United States in the sale of new and used automobiles, light trucks and passenger vans. Through our automobile contract purchases, we provide indirect financing to sub-prime customers of dealers. We serve as an alternative source of financing for dealers, facilitating sales to customers who otherwise might not be able to obtain financing from traditional sources, such as commercial banks, credit unions and the captive finance companies affiliated with major automobile manufacturers. In addition to purchasing installment purchase contracts directly from dealers, we have also (i) acquired installment purchase contracts in four merger and acquisition transactions, (ii) purchased immaterial amounts of vehicle purchase money loans from non-affiliated lenders, and (iii) lent money directly to consumers for an immaterial amount of loans secured by vehicles. In this report, we refer to all of such contracts and loans as "automobile contracts."

We were incorporated and began our operations in March 1991. From inception through September 30, 2016, we have purchased a total of approximately \$13.3 billion of automobile contracts from dealers. In addition, we obtained a total of approximately \$822.3 million of automobile contracts in mergers and acquisitions in 2002, 2003, 2004 and 2011. In 2004 and 2009, we were appointed as a third-party servicer for certain portfolios of automobile receivables originated and owned by non-affiliated entities. Beginning in 2008 through the third quarter of 2011, our managed portfolio decreased each year due to our strategy of limiting contract purchases in 2008 and 2009 to conserve our liquidity, as discussed further below. However, since October 2009 we have gradually increased contract purchases, which, in turn has resulted in recent increases to our managed portfolio. Recent contract purchase volumes and managed portfolio levels are shown in the table below:

### Contract Purchases and Outstanding Managed Portfolio

| Period                               | \$ in thousands               |                                 |
|--------------------------------------|-------------------------------|---------------------------------|
|                                      | Contracts Purchased in Period | Managed Portfolio at Period End |
| 2008                                 | \$ 296,817                    | \$ 1,664,122                    |
| 2009                                 | 8,599                         | 1,194,722                       |
| 2010                                 | 113,023                       | 756,203                         |
| 2011                                 | 284,236                       | 794,649                         |
| 2012                                 | 551,742                       | 897,575                         |
| 2013                                 | 764,087                       | 1,231,422                       |
| 2014                                 | 944,944                       | 1,643,920                       |
| 2015                                 | 1,060,538                     | 2,031,136                       |
| Nine months ended September 30, 2016 | 873,499                       | 2,291,865                       |

Our principal executive offices are in Las Vegas, Nevada. Most of our operational and administrative functions take place in Irvine, California. Credit and underwriting functions are performed primarily in our California branch with certain of these functions also performed in our Florida and Nevada branches. We service our automobile contracts from our California, Nevada, Virginia, Florida and Illinois branches.

The programs we offer to dealers are intended to serve a wide range of sub-prime customers, primarily through franchised new car dealers. We purchase automobile contracts with the intention of financing them on a long-term basis through securitizations. Securitizations are transactions in which we sell a specified pool of contracts to a special purpose subsidiary of ours, which in turn issues asset-backed securities to fund the purchase of the pool of contracts from us.

### Securitization and Warehouse Credit Facilities

Throughout the period for which information is presented in this report, we have purchased automobile contracts with the intention of financing them on a long-term basis through securitizations, and on an interim basis through warehouse credit facilities. All such financings have involved identification of specific automobile contracts, sale of those automobile contracts (and associated rights) to one of our special-purpose subsidiaries, and issuance of asset-backed securities to fund the transactions. Depending on the structure, these transactions may be accounted for under generally accepted accounting principles as sales of the automobile contracts or as secured financings.

When structured to be treated as a secured financing for accounting purposes, the subsidiary is consolidated with us. Accordingly, the sold automobile contracts and the related debt appear as assets and liabilities, respectively, on our unaudited condensed consolidated balance sheet. We then periodically (i) recognize interest and fee income on the contracts, (ii) recognize interest expense on the securities issued in the transaction and (iii) record as expense a provision for credit losses on the contracts.

Since 1994 we have conducted 71 term securitizations (generally quarterly) of automobile contracts that we purchased from dealers under our regular programs. As of September 30, 2016, 17 of those securitizations are active and all but one are structured as secured financings. Our September 2010 transaction is our only active securitization that is structured as a sale of the related contracts. From 1994 through April 2008 we generally utilized financial guarantees for the senior asset-backed notes issued in the securitization. Since September 2010 we have utilized senior subordinated structures without any financial guarantees. We have generally conducted our securitizations on a quarterly basis, near the end of each calendar quarter, resulting in four securitizations per calendar year. However, in 2015, we elected to defer what would have been our December securitization in favor of a securitization in January 2016. We also completed securitizations in April, July and October 2016.

Our recent history of term securitizations is summarized in the table below:

| <b>Recent Asset-Backed Term Securitizations</b> |                                       |  |
|---|---------------------------------------|--|
| <i>\$ in thousands</i>                          |                                       |  |
| <b>Period</b>                                   | <b>Number of Term Securitizations</b> | <b>Receivables Pledged in Term Securitizations</b> |
| 2006  | 4                                     | \$ 957,681   |
| 2007  | 3                                     | 1,118,097  |
| 2008  | 2                                     | 509,022  |
| 2009  | 0                                     | –  |
| 2010  | 1                                     | 103,772  |
| 2011  | 3                                     | 335,593  |
| 2012  | 4                                     | 603,500  |
| 2013  | 4                                     | 778,000  |
| 2014  | 4                                     | 923,000  |
| 2015  | 3                                     | 795,000  |
| Nine months ended September 30, 2016            | 3                                     | 1,004,997  |

From time to time we have also completed financings of our residual interests in other securitizations that we and our affiliates previously sponsored. As of September 30, 2016 we have one such residual interest financing outstanding.

Since December 2011, our securitizations have included a pre-funding feature in which a portion of the receivables to be sold to the trust were not delivered until after the initial closing. As a result, our restricted cash balance at September 30, 2015 included \$102.1 million from the proceeds of the sale of the asset-backed notes that were held by the trustee pending delivery of the remaining receivables. In October 2015, the requisite additional receivables were delivered to the trust and we received the related restricted cash, most of which was used to repay amounts owed under our warehouse credit facilities. Since we have changed the timing of our securitizations to generally occur at the beginning rather than the end of the calendar quarter, there was no related amount of restricted cash representing the pre-funding proceeds at September 30, 2016.

Generally, prior to a securitization transaction we fund our automobile contract purchases primarily with proceeds from warehouse credit facilities. Our current short-term funding capacity is \$300 million, comprising three credit facilities. The first \$100 million credit facility was established in May 2012. This facility was renewed in August 2016, extending the revolving period to August 2018, and adding an amortization period through August 2019. In April 2015, we entered into a new \$100 million facility, with a revolving period extending to April 2017, followed by an amortization period to April 2019. In November 2015, we entered into a third \$100 million facility, with a revolving period extending to November 2017, followed by an amortization period to November 2019.

## Financial Covenants

Certain of our securitization transactions and our warehouse credit facilities contain various financial covenants requiring certain minimum financial ratios and results. Such covenants include maintaining minimum levels of liquidity and net worth and not exceeding maximum leverage levels. In addition, certain of our debt agreements other than our term securitizations contain cross-default provisions. Such cross-default provisions would allow the respective creditors to declare a default if an event of default occurred with respect to other indebtedness of ours, but only if such other event of default were to be accompanied by acceleration of such other indebtedness. As of September 30, 2016 we were in compliance with all such covenants.

## Results of Operations

*Comparison of Operating Results for the three months ended September 30, 2016 with the three months ended September 30, 2015*

*Revenues* . During the three months ended September 30, 2016, our revenues were \$108.5 million, an increase of \$14.5 million, or 15.5%, from the prior year revenue of \$94.0 million. The primary reason for the increase in revenues is an increase in interest income. Interest income for the three months ended September 30, 2016 increased \$14.8 million, or 16.3%, to \$105.4 million from \$90.6 million in the prior year. The primary reason for the increase in interest income is the increase in finance receivables held by consolidated subsidiaries. The table below shows the outstanding and average balances of our portfolio held by consolidated subsidiaries for the three months ended September 30, 2016 and 2015:

|   | <u>September 30, 2016</u> |    | <u>September 30, 2015</u> |
|---|---------------------------|----|---------------------------|
|   | <u>Amount</u>             |    | <u>Amount</u>             |
|   | (in millions)             |    |                           |
| <b>Finance Receivables Owned by Consolidated Subsidiaries</b> |                           |    |                           |
| Average balance for the three-month period                    | \$ 2,281.5                | \$ | 1,902.4                   |
| Ending balance for the period                                 | \$ 2,291.7                | \$ | 1,939.8                   |

Servicing fees totaling \$26,000 for the three months ended September 30, 2016 decreased \$47,000, or 64.4%, from \$72,000 in the prior year. We earn base servicing fees on three portfolios and incentive servicing fees on one of those three portfolios. All three of these portfolios are decreasing in size as we receive customer payments and, consequently, base servicing and incentive servicing fees are decreasing also. The aggregate balance of portfolios generating servicing fees decreased to \$143,000 at September 30, 2016 from \$598,000 at September 30, 2015.

In the three months ended September 30, 2016, other income of \$3.1 million decreased by \$220,000, or 6.6% compared to the prior year. The three-month period ended September 30, 2016 includes a decrease of \$336,000 in revenue associated with direct mail and other related products and services that we offer to our dealers and a decrease of \$60,000 in payments from third-party providers of convenience fees paid by our customers for web based and other electronic payments. The decreases were somewhat offset by an increase of \$66,000 in sales tax refunds and a net increase of \$110,000 on payments to us for our interest in certain sold charge off portfolios and acquired third-party portfolios.

*Expenses* . Our operating expenses consist largely of provision for credit losses, interest expense, employee costs, marketing and general and administrative expenses. Provision for credit losses and interest expense are significantly affected by the volume of automobile contracts we purchased during the trailing 12-month period and by the outstanding balance of finance receivables held by consolidated subsidiaries. Employee costs and general and administrative expenses are incurred as applications and automobile contracts are received, processed and serviced. Factors that affect margins and net income include changes in the automobile and automobile finance market environments, and macroeconomic factors such as interest rates and changes in the unemployment level.

Employee costs include base salaries, commissions and bonuses paid to employees, and certain expenses related to the accounting treatment of outstanding stock options, and are one of our most significant operating expenses. These costs (other than those relating to stock options) generally fluctuate with the level of applications and automobile contracts processed and serviced.

Other operating expenses consist largely of facilities expenses, telephone and other communication services, credit services, computer services, marketing and advertising expenses, and depreciation and amortization.

Total operating expenses were \$96.1 million for the three months ended September 30, 2016, compared to \$78.3 million for the prior year, an increase of \$17.7 million, or 22.6%. The increase is primarily due the increase in our consolidated portfolio and associated servicing costs, and the related increases in interest expense and in our provision for credit losses.

Employee costs increased by \$1.4 million or 9.4%, to \$16.7 million during the three months ended September 30, 2016, representing 17.4% of total operating expenses, from \$15.3 million for the prior year, or 17.1% of total operating expenses. Since 2010, we have added employees in our Originations and Marketing departments in conjunction with the increase in contract purchases. Since 2013, we have also added Servicing staff to accommodate the increase in the number of accounts in our managed portfolio. The table below summarizes our employees by category as well as contract purchases and units in our managed portfolio as of, and for the three-month periods ended, September 30, 2016 and 2015:

|   | <u>September 30, 2016</u> | <u>September 30, 2015</u> |
|---|---------------------------|---------------------------|
|   | <u>Amount</u>             | <u>Amount</u>             |
|   | <u>(\$ in millions)</u>   |                           |
| Contracts purchased (dollars)           | \$ 242.1                  | \$ 287.5                  |
| Contracts purchased (units)             | 14,706                    | 17,019                    |
| Managed portfolio outstanding (dollars) | \$ 2,291.9                | \$ 1,940.6                |
| Managed portfolio outstanding (units)   | 167,636                   | 143,036                   |
| Number of Originations staff            | 225                       | 229                       |
| Number of Marketing staff               | 98                        | 134                       |
| Number of Servicing staff               | 521                       | 462                       |
| Number of other staff                   | 110                       | 78                        |
| Total number of employees               | <u>954</u>                | <u>903</u>                |

General and administrative expenses include costs associated with purchasing and servicing our portfolio of finance receivables, including expenses for facilities, credit services, and telecommunications. General and administrative expenses were \$6.3 million, an increase of \$1.3 million, or 26.1% compared to the previous year and represented 6.6% of total operating expenses.

Interest expense for the three months ended September 30, 2016 increased by \$6.0 million to \$20.9 million, or 40.7% and represented 21.7% of total operating expenses, compared to \$14.8 million in the previous year, when it was 21.1% of total operating expenses.

Interest on securitization trust debt increased by \$5.8 million, or 46.2%, for the three months ended September 30, 2016 compared to the prior year. The average balance of securitization trust debt increased 22.5% to \$2,154.4 million at September 30, 2016 compared to \$1,758.4 million at September 30, 2015. In addition, the blended interest rates on new term securitizations have generally increased since June 2014. As a result, the cost of securitization debt during the three month period ended September 30, 2016 was 3.4%, compared to 2.8% in the prior year period. For any particular quarterly securitization transaction, the blended cost of funds is ultimately the result of many factors including the market interest rates for benchmark swaps of various maturities against which our bonds are priced and the margin over those benchmarks that investors are willing accept, which in turn, is influenced by investor demand for our bonds at the time of the securitization. These and other factors have resulted in a general trend toward higher securitization trust debt interest costs since June 2014, although that trend has reversed somewhat since July 2016. The blended interest rates of our recent securitizations are summarized in the table below:

#### Blended Cost of Funds on Recent Asset-Backed Term Securitizations

| Period         | Blended Cost of Funds |
|----------------|-----------------------|
| June 2014      | 2.37%                 |
| September 2014 | 2.71%                 |
| December 2014  | 3.07%                 |
| March 2015     | 3.04%                 |
| June 2015      | 3.18%                 |
| September 2015 | 3.78%                 |
| January 2016   | 4.34%                 |
| April 2016     | 4.65%                 |
| July 2016      | 4.48%                 |
| October 2016   | 3.66%                 |

Interest expense on subordinated renewable notes decreased by \$73,000, or 18.3%. The decrease is due to a decrease in the average yield on our subordinated renewable notes to 8.9% for the three-month period ended September 30, 2016 compared to the prior year when the average yield on our subordinated renewable notes was 10.6%. In addition, the average balance decreased to \$14.7 million for the three-month period ended September 30, 2016 compared to \$15.1 million in the prior year period.

Interest expense on warehouse debt increased by \$467,000, or 28.4%, for the three months ended September 30, 2016 compared to the prior year. When possible, we hold contracts with our own cash rather than pledging them to one of our warehouse facilities to minimize interest expense.

The following table presents the components of interest income and interest expense and a net interest yield analysis for the three-month periods ended September 30, 2016 and 2015:

|   | Three Months Ended September 30,     |                  |                       |                        |                  |                                     |
|---|--------------------------------------|------------------|-----------------------|------------------------|------------------|-------------------------------------|
|   | 2016                                 |                  |                       | 2015                   |                  |                                     |
|   | Annualized<br>Average<br>Balance (1) | Interest         | Average<br>Yield/Rate | Average<br>Balance (1) | Interest         | Annualized<br>Average<br>Yield/Rate |
| <b>Interest Earning Assets</b>  |                                      |                  |                       |                        |                  |                                     |
| Finance receivables gross (2)   | \$ 2,247,917                         | \$ 105,376       | 18.8%                 | \$ 1,876,688           | \$ 90,584        | 19.3%                               |
| <b>Interest Bearing Liabilities</b>   |                                      |                  |                       |                        |                  |                                     |
| Warehouse lines of credit (3)   | \$ 74,602                            | 2,111            | 11.2%                 | \$ 67,698              | 1,644            | 9.7%                                |
| Residual interest financing   | 7,055                                | 227              | 12.9%                 | 10,905                 | 338              | 12.4%                               |
| Securitization trust debt   | 2,154,424                            | 18,228           | 3.4%                  | 1,758,434              | 12,466           | 2.8%                                |
| Subordinated renewable notes  | 14,739                               | 327              | 8.9%                  | 15,102                 | 400              | 10.6%                               |
|   | <u>\$ 2,250,820</u>                  | <u>20,893</u>    | <u>3.7%</u>           | <u>\$ 1,852,139</u>    | <u>14,848</u>    | <u>3.2%</u>                         |
| Net interest income/spread  |                                      | <u>\$ 84,483</u> |                       |                        | <u>\$ 75,736</u> |                                     |
| Net interest yield (4)  |                                      |                  | 15.0%                 |                        |                  | 16.1%                               |
| Ratio of average interest earning assets to<br>average interest bearing liabilities |                                      |                  | 100%                  |                        |                  | 101%                                |

(1) Average balances are based on month end balances except for warehouse lines of credit, which are based on daily balances.

(2) Net of deferred fees and direct costs.

(3) Interest expense includes deferred financing costs and non-utilization fees.

(4) Annualized net interest income divided by average interest earning assets.

|                                     | Three Months Ended September 30, 2016<br>Compared to September 30, 2015 |                         |                       |
|-------------------------------------|---|-------------------------|-----------------------|
|                                     | Total<br>Change   | Change Due<br>to Volume | Change Due<br>to Rate |
|                                     | (In thousands)  |                         |                       |
| <b>Interest Earning Assets</b>      |   |                         |                       |
| Finance receivables gross           | \$ 14,792   | \$ 17,918               | \$ (3,126)            |
| <b>Interest Bearing Liabilities</b> |   |                         |                       |
| Warehouse lines of credit           | 467   | 185                     | 282                   |
| Residual interest financing         | (111)   | (119)                   | 8                     |
| Securitization trust debt           | 5,762   | 2,807                   | 2,955                 |
| Subordinated renewable notes        | (73)  | (10)                    | (63)                  |
|                                     | <u>6,045</u>  | <u>2,863</u>            | <u>3,182</u>          |
| Net interest income/spread          | <u>\$ 8,747</u>   | <u>\$ 15,055</u>        | <u>\$ (6,308)</u>     |

The reduction in the annualized yield on our finance receivables for the three months ended September 30, 2016 compared to the prior year period is the result of our decision to offer dealers slightly lower acquisition fees and also to require slightly lower contract interest rates on a portion of the contracts we purchase.

Provision for credit losses was \$46.3 million for the three months ended September 30, 2016, an increase of \$8.9 million, or 23.7% compared to the prior year and represented 48.2% of total operating expenses. The provision for credit losses maintains the allowance for finance credit losses at levels that we feel are adequate for probable incurred credit losses that can be reasonably estimated. Our approach for establishing the allowance requires greater amounts of provision for credit losses early in the terms of our finance receivables. In addition, we monitor the delinquency and net charge off rates in our portfolio to consider how such rates may affect the allowance for finance credit losses. Consequently, the increase in provision expense is the result of the increase in contract purchases, the larger portfolio owned by our consolidated subsidiaries, and somewhat higher delinquency and charge off rates compared to the prior year.

Marketing expenses consist primarily of commission-based compensation paid to our employee marketing representatives. Our marketing representatives earn a salary plus commissions based on volume of contract purchases and sales of ancillary products and services that we offer our dealers, such as training programs, internet lead sales, and direct mail products. Marketing expenses decreased by \$145,000, or 3.1%, to \$4.5 million during the three months ended September 30, 2016, compared to \$4.6 million in the prior year period, and represented 4.6% of total operating expenses. For the three months ended September 30, 2016, we purchased 14,706 contracts representing \$242.1 million in receivables compared to 17,019 contracts representing \$287.5 million in receivables in the prior year. In addition, the number of employees in our marketing department decreased from 134 at September 30 2015 to 98 at September 30, 2016.

Occupancy expenses increased by \$191,000 or 18.2%, to \$1.2 million compared to \$1.0 million in the previous year and represented 1.3% of total operating expenses. In July 2015, we entered into a lease for additional office space in Irvine, California. We then occupied that space, and incurred incremental occupancy expense, in phases. The first phase was in July 2015 and the second and final phase was in April 2016.

Depreciation and amortization expenses increased by \$32,000 or 18.8%, to \$202,000 compared to \$170,000 in the previous year and represented 0.2% of total operating expenses.

For the three months ended September 30, 2016, we recorded income tax expense of \$5.1 million, representing a 41.0% effective income tax rate. In the prior year period, we recorded \$6.8 million in income tax expense, representing a 43.5% effective income tax rate.

*Comparison of Operating Results for the nine months ended September 30, 2016 with the nine months ended September 30, 2015*

*Revenues* . During the nine months ended September 30, 2016, our revenues were \$314.1 million, an increase of \$45.8 million, or 17.1%, from the prior year revenue of \$268.3 million. The primary reason for the increase in revenues is an increase in interest income. Interest income for the nine months ended September 30, 2016 increased \$45.9 million, or 17.8%, to \$303.7 million from \$257.8 million in the prior year. The primary reason for the increase in interest income is the increase in finance receivables held by consolidated subsidiaries. The table below shows the outstanding and average balances of our portfolio held by consolidated subsidiaries for the nine months ended September 30, 2016 and 2015:

|   | <u>September 30, 2016</u> |         | <u>September 30, 2015</u> |         |
|---|---------------------------|---------|---------------------------|---------|
|   | Amount                    |         | Amount                    |         |
| (\$ in millions)  |                           |         |                           |         |
| <b>Finance Receivables Owned by Consolidated Subsidiaries</b> |                           |         |                           |         |
| Average balance for the nine-month period                     | \$                        | 2,157.3 | \$                        | 1,793.3 |
| Ending balance for the period                                 | \$                        | 2,291.7 | \$                        | 1,939.8 |

Servicing fees totaling \$73,000 for the nine months ended September 30, 2016 decreased \$210,000, or 74.1%, from \$283,000 in the prior year. We earn base servicing fees on three portfolios and incentive servicing fees on one of those three portfolios. All three of these portfolios are decreasing in size as we receive customer payments and, consequently, base servicing and incentive servicing fees are decreasing also. The aggregate balance of portfolios generating servicing fees decreased to \$143,000 at September 30, 2016 from \$598,000 at September 30, 2015.

In the nine months ended September 30, 2016, other income of \$10.3 million increased by \$63,000, or 0.6% compared to the prior year. The nine-month period ended September 30, 2016 includes increases of \$367,000 in revenue associated with direct mail and other related products and services that we offer to our dealers and an increase of \$173,000 in sales tax refunds. The increases were somewhat offset by a net decrease of \$42,000 on payments to us for our interest in certain sold charge off portfolios and acquired third-party portfolios and a decrease of \$435,000 in payments from third-party providers of convenience fees paid by our customers for web based and other electronic payments.

*Expenses* . Our operating expenses consist largely of provision for credit losses, interest expense, employee costs, marketing and general and administrative expenses. Provision for credit losses and interest expense are significantly affected by the volume of automobile contracts we purchased during the trailing 12-month period and by the outstanding balance of finance receivables held by consolidated subsidiaries. Employee costs and general and administrative expenses are incurred as applications and automobile contracts are received, processed and serviced. Factors that affect margins and net income include changes in the automobile and automobile finance market environments, and macroeconomic factors such as interest rates and changes in the unemployment level.

Employee costs include base salaries, commissions and bonuses paid to employees, and certain expenses related to the accounting treatment of outstanding stock options, and are one of our most significant operating expenses. These costs (other than those relating to stock options) generally fluctuate with the level of applications and automobile contracts processed and serviced.

Other operating expenses consist largely of facilities expenses, telephone and other communication services, credit services, computer services, marketing and advertising expenses, and depreciation and amortization.

Total operating expenses were \$277.1 million for the nine months ended September 30, 2016, compared to \$222.7 million for the prior year, an increase of \$54.3 million, or 24.4%. The increase is primarily due to costs associated with the increase in the amount of new contracts we purchased, the resulting increase in our consolidated portfolio and associated servicing costs, and the related increases in interest expense and in our provision for credit losses.

Employee costs increased by \$4.6 million or 10.8%, to \$47.5 million during the nine months ended September 30, 2016, representing 17.1% of total operating expenses, from \$42.9 million for the prior year, or 19.3% of total operating expenses. Since 2010, we have generally added employees in our Originations and Marketing departments in conjunction with the increase in contract purchases, although more recently our Marketing and Originations departments have not grown. Since 2013, we have also added Servicing staff to accommodate the increase in the number of accounts in our managed portfolio. The table below summarizes our employees by category as well as contract purchases and units in our managed portfolio as of, and for the nine-month periods ended, September 30, 2016 and 2015:

|   | <u>September 30, 2016</u> | <u>September 30, 2015</u> |
|---|---------------------------|---------------------------|
|   | <u>Amount</u>             | <u>Amount</u>             |
|   | (\$ in millions)          |                           |
| Contracts purchased (dollars)           | \$ 873.5                  | \$ 791.3                  |
| Contracts purchased (units)             | 53,244                    | 48,046                    |
| Managed portfolio outstanding (dollars) | \$ 2,291.9                | \$ 1,940.6                |
| Managed portfolio outstanding (units)   | 167,636                   | 145,036                   |
| Number of Originations staff            | 225                       | 229                       |
| Number of Marketing staff               | 98                        | 134                       |
| Number of Servicing staff               | 521                       | 462                       |
| Number of other staff                   | 110                       | 78                        |
| Total number of employees               | <u>954</u>                | <u>903</u>                |

General and administrative expenses include costs associated with purchasing and servicing our portfolio of finance receivables, including expenses for facilities, credit services, and telecommunications. General and administrative expenses were \$18.2 million, an increase of \$3.3 million, or 21.9% compared to the previous year and represented 6.6% of total operating expenses.

Interest expense for the nine months ended September 30, 2016 increased by \$16.7 million to \$58.4 million, or 40.1% and represented 21.1% of total operating expenses, compared to \$41.7 million in the previous year, when it was 18.7% of total operating expenses.

Interest on securitization trust debt increased by \$14.9 million, or 42.4%, for the nine months ended September 30, 2016 compared to the prior year. The average balance of securitization trust debt increased 22.6% to \$2,046.8 million at September 30, 2016 compared to \$1,668.9 million at September 30, 2015. In addition, the blended interest rates on new term securitizations have generally increased since June 2014. As a result, the cost of securitization debt during the three month period ended September 30, 2016 was 3.4%, compared to 2.8% in the prior year period. For any particular quarterly securitization transaction, the blended cost of funds is ultimately the result of many factors including the market interest rates for benchmark swaps of various maturities against which our bonds are priced and the margin over those benchmarks that investors are willing accept, which in turn, is influenced by investor demand for our bonds at the time of the securitization. These and other factors have resulted in a general trend toward higher securitization trust debt interest costs since June 2014, although that trend has reversed somewhat since July 2016. The blended interest rates of our recent securitizations are summarized in the table below:

**Blended Cost of Funds on Recent Asset-Backed Term Securitizations**

| Period         | Blended Cost of Funds |
|----------------|-----------------------|
| June 2014      | 2.37%                 |
| September 2014 | 2.71%                 |
| December 2014  | 3.07%                 |
| March 2015     | 3.04%                 |
| June 2015      | 3.18%                 |
| September 2015 | 3.78%                 |
| January 2016   | 4.34%                 |
| April 2016     | 4.65%                 |
| July 2016      | 4.48%                 |
| October 2016   | 3.66%                 |

Interest expense on subordinated renewable notes decreased by \$156,000, or 12.9%. The decrease is due to a decrease in the average yield on our subordinated renewable notes to 9.3% for the nine-month period ended September 30, 2016 compared to the prior year when the average yield on our subordinated renewable notes was 10.7%. The decrease in the yield offset an increase in the average balance to \$15.2 million for the nine-month period ended September 30, 2016 compared to \$15.1 million in the prior year period.

Interest expense on warehouse debt increased by \$2.4 million, or 54.9% for the nine months ended September 30, 2016 compared to the prior year. We increased our contract purchases to \$873.5 million for the nine months ended September 30, 2016 compared to \$791.3 million in the prior period. However, when possible, we hold contracts with our own cash rather than pledging them to one of our warehouse facilities to minimize interest expense.

The following table presents the components of interest income and interest expense and a net interest yield analysis for the nine-month periods ended September 30, 2016 and 2015:

**Nine Months Ended September 30,**

|   | 2016                   |                                   |             | 2015                   |                   |                                     |
|---|------------------------|-----------------------------------|-------------|------------------------|-------------------|-------------------------------------|
|   | Average<br>Balance (1) | Annualized<br>Average<br>Interest | Yield/Rate  | Average<br>Balance (1) | Interest          | Annualized<br>Average<br>Yield/Rate |
| <b>(Dollars in thousands)</b>   |                        |                                   |             |                        |                   |                                     |
| <b>Interest Earning Assets</b>  |                        |                                   |             |                        |                   |                                     |
| Finance receivables gross (2)   | \$ 2,162,357           | \$ 303,748                        | 18.7%       | \$ 1,771,237           | \$ 257,843        | 19.4%                               |
| <b>Interest Bearing Liabilities</b>   |                        |                                   |             |                        |                   |                                     |
| Warehouse lines of credit (3)   | \$ 85,364              | 6,777                             | 10.6%       | \$ 58,974              | 4,376             | 9.9%                                |
| Residual interest financing   | 7,811                  | 744                               | 12.7%       | 11,512                 | 1,111             | 12.9%                               |
| Securitization trust debt   | 2,046,847              | 49,867                            | 3.2%        | 1,668,934              | 35,012            | 2.8%                                |
| Subordinated renewable notes  | 15,155                 | 1,054                             | 9.3%        | 15,101                 | 1,210             | 10.7%                               |
|   | <u>\$ 2,155,177</u>    | <u>58,442</u>                     | <u>3.6%</u> | <u>\$ 1,754,521</u>    | <u>41,709</u>     | <u>3.1%</u>                         |
| Net interest income/spread  |                        | <u>\$ 245,306</u>                 |             |                        | <u>\$ 216,134</u> |                                     |
| Net interest yield (4)  |                        |                                   | 15.1%       |                        |                   | 16.3%                               |
| Ratio of average interest earning assets to<br>average interest bearing liabilities |                        |                                   | 100%        |                        |                   | 101%                                |

(1) Average balances are based on month end balances except for warehouse lines of credit, which are based on daily balances.

(2) Net of deferred fees and direct costs.

(3) Interest expense includes deferred financing costs and non-utilization fees.

(4) Annualized net interest income divided by average interest earning assets.

**Nine Months Ended September 30, 2016  
Compared to September 30, 2015**

|                                     | Total<br>Change       | Change Due<br>to Volume | Change Due<br>to Rate |
|-------------------------------------|-----------------------|-------------------------|-----------------------|
|                                     | <b>(In thousands)</b> |                         |                       |
| <b>Interest Earning Assets</b>      |                       |                         |                       |
| Finance receivables gross           | \$ 45,905             | \$ 60,405               | \$ (14,500)           |
| <b>Interest Bearing Liabilities</b> |                       |                         |                       |
| Warehouse lines of credit           | \$ 2,401              | 1,816                   | 585                   |
| Residual interest financing         | (367)                 | (351)                   | (16)                  |
| Securitization trust debt           | 14,855                | 5,677                   | 9,178                 |
| Subordinated renewable notes        | (156)                 | 60                      | (216)                 |
|                                     | <u>16,733</u>         | <u>7,202</u>            | <u>9,531</u>          |
| Net interest income/spread          | <u>\$ 29,172</u>      | <u>\$ 53,203</u>        | <u>\$ (24,031)</u>    |

The reduction in the annualized yield on our finance receivables for the nine months ended September 30, 2016 compared to the prior year period is the result of our decision to offer dealers slightly lower acquisition fees and also to require slightly lower contract interest rates on a portion of the contracts we purchase.

Provision for credit losses was \$134.9 million for the nine months ended September 30, 2016, an increase of \$28.3 million, or 26.6% compared to the prior year and represented 47.7% of total operating expenses. The provision for credit losses maintains the allowance for finance credit losses at levels that we feel are adequate for probable incurred credit losses that can be reasonably estimated. Our approach for establishing the allowance requires greater amounts of provision for credit losses early in the terms of our finance receivables. In addition, we monitor the delinquency and net charge off rates in our portfolio to consider how such rates may affect the allowance for finance credit losses. Consequently, the increase in provision expense is the result of the increase in contract purchases, the larger portfolio owned by our consolidated subsidiaries, and somewhat higher delinquency and charge off rates compared to the prior year.

Marketing expenses consist primarily of commission-based compensation paid to our employee marketing representatives. Our marketing representatives earn a salary plus commissions based on volume of contract purchases and sales of ancillary products and services that we offer our dealers, such as training programs, internet lead sales, and direct mail products. Marketing expenses increased by \$617,000, or 4.7%, to \$13.9 million during the nine months ended September 30, 2016, compared to \$13.2 million in the prior year period, and represented 5.0% of total operating expenses. For the nine months ended September 30, 2016, we purchased 53,244 contracts representing \$873.5 million in receivables compared to 48,046 contracts representing \$791.3 million in receivables in the prior year.

Occupancy expenses increased by \$658,000 or 22.3%, to \$3.6 million compared to \$3.0 million in the previous year and represented 1.3% of total operating expenses. In July 2015, we entered into a lease for additional office space in Irvine, California. We then occupied that space, and incurred incremental occupancy expense, in phases. The first phase was in July 2015 and the second and final phase was in April 2016.

Depreciation and amortization expenses increased by \$97,000 or 20.5%, to \$568,000 compared to \$471,000 in the previous year and represented 0.2% of total operating expenses.

For the nine months ended September 30, 2016, we recorded income tax expense of \$15.2 million, representing a 41.0% effective income tax rate. In the prior year period, we recorded \$19.9 million in income tax expense, representing a 43.6% effective income tax rate.

### **Credit Experience**

Our financial results are dependent on the performance of the automobile contracts in which we retain an ownership interest. Broad economic factors such as recession and significant changes in unemployment levels influence the credit performance of our portfolio, as does the weighted average age of the receivables at any given time. In addition, in June 2014 we entered into a consent decree with the FTC that required us to make certain procedural changes in our servicing practices, which we believe have contributed to somewhat higher delinquencies and extensions compared to prior periods. The tables below document the delinquency, repossession and net credit loss experience of all such automobile contracts that we originated or own an interest in as of the respective dates shown. The tables do not include the experience of third party originated and owned portfolios.

## Delinquency, Repossession and Extension Experience (1)

### Total Owned Portfolio

|   | September 30, 2016     |                          | September 30, 2015     |                          | December 31, 2015      |                          |
|---|------------------------|--------------------------|------------------------|--------------------------|------------------------|--------------------------|
|   | Number of<br>Contracts | Amount                   | Number of<br>Contracts | Amount                   | Number of<br>Contracts | Amount                   |
|   | (Dollars in thousands) |                          |                        |                          |                        |                          |
| <b>Delinquency Experience</b>   |                        |                          |                        |                          |                        |                          |
| Gross servicing portfolio (1)   | 167,629                | \$ 2,291,854             | 142,913                | \$ 1,940,311             | 149,138                | \$ 2,031,099             |
| Period of delinquency (2)   |                        |                          |                        |                          |                        |                          |
| 31-60 days  | 8,843                  | \$ 119,283               | 5,504                  | \$ 69,608                | 5,375                  | \$ 70,041                |
| 61-90 days  | 3,882                  | 50,248                   | 3,129                  | 38,940                   | 3,140                  | 41,142                   |
| 91+ days  | 2,780                  | 36,277                   | 2,456                  | 33,124                   | 3,364                  | 43,484                   |
| Total delinquencies (2)   | <u>15,505</u>          | <u>205,808</u>           | <u>11,089</u>          | <u>141,672</u>           | <u>11,879</u>          | <u>154,667</u>           |
| Amount in repossession (3)  | <u>2,632</u>           | <u>33,837</u>            | <u>2,335</u>           | <u>29,247</u>            | <u>3,138</u>           | <u>38,939</u>            |
| Total delinquencies and amount in repossession (2)  | <u><u>18,137</u></u>   | <u><u>\$ 239,645</u></u> | <u><u>13,424</u></u>   | <u><u>\$ 170,919</u></u> | <u><u>15,017</u></u>   | <u><u>\$ 193,606</u></u> |
| Delinquencies as a percentage of gross servicing portfolio                                  | 9.2%                   | 9.0%                     | 7.8%                   | 7.3%                     | 8.0%                   | 7.6%                     |
| Total delinquencies and amount in repossession as a percentage of gross servicing portfolio | 10.8%                  | 10.5%                    | 9.4%                   | 8.8%                     | 10.1%                  | 9.5%                     |
| <b>Extension Experience</b>   |                        |                          |                        |                          |                        |                          |
| Contracts with one extension, accruing (4)  | 31,213                 | \$ 431,533               | 24,679                 | \$ 333,576               | 26,682                 | \$ 361,338               |
| Contracts with two or more extensions, accruing (4)   | <u>25,246</u>          | <u>334,563</u>           | <u>14,617</u>          | <u>191,760</u>           | <u>16,638</u>          | <u>219,175</u>           |
|   | 56,459                 | 766,096                  | 39,296                 | 525,336                  | 43,320                 | 580,513                  |
| Contracts with one extension, non-accrual (4)   | 1,314                  | 16,948                   | 1,259                  | 16,584                   | 1,784                  | 22,725                   |
| Contracts with two or more extensions, non-accrual (4)                                      | <u>1,650</u>           | <u>21,365</u>            | <u>886</u>             | <u>11,282</u>            | <u>1,444</u>           | <u>18,527</u>            |
|   | 2,964                  | 38,313                   | 2,145                  | 27,866                   | 3,228                  | 41,252                   |
| Total contracts with extensions   | <u><u>59,423</u></u>   | <u><u>\$ 804,409</u></u> | <u><u>41,441</u></u>   | <u><u>\$ 553,202</u></u> | <u><u>46,548</u></u>   | <u><u>\$ 621,765</u></u> |

(1) All amounts and percentages are based on the amount remaining to be repaid on each automobile contract, including, for pre-computed automobile contracts, any unearned interest. The information in the table represents the gross principal amount of all automobile contracts we have purchased, including automobile contracts subsequently sold in securitization transactions that we continue to service. The table does not include certain contracts we have serviced for third parties on which we earn servicing fees only and have no credit risk.

(2) We consider an automobile contract delinquent when an obligor fails to make at least 90% of a contractually due payment by the following due date, which date may have been extended within limits specified in the Servicing Agreements. The period of delinquency is based on the number of days payments are contractually past due. Automobile contracts less than 31 days delinquent are not included. The delinquency aging categories shown in the tables reflect the effect of extensions.

(3) Amount in repossession represents financed vehicles that have been repossessed but not yet liquidated.

(4) Accounts past due more than 90 days are on non-accrual.

**Net Charge-Off Experience (1)**  
**Total Owned Portfolio**

|   | September 30,<br>2016  | September 30,<br>2015 | December 31,<br>2015 |
|---|------------------------|-----------------------|----------------------|
|   | (Dollars in thousands) |                       |                      |
| Average servicing portfolio outstanding                                       | \$ 2,198,906           | \$ 1,797,004          | \$ 1,847,764         |
| Annualized net charge-offs as a percentage of average servicing portfolio (2) | 7.1%                   | 6.5%                  | 6.4%                 |

(1) All amounts and percentages are based on the principal amount scheduled to be paid on each automobile contract, net of unearned income on pre-computed automobile contracts.

(2) Net charge-offs include the remaining principal balance, after the application of the net proceeds from the liquidation of the vehicle (excluding accrued and unpaid interest) and amounts collected subsequent to the date of charge-off, including some recoveries which have been classified as other income in the accompanying interim consolidated financial statements. September 30, 2016 and September 30, 2015 percentage represents nine months ended September 30, 2016 and September 30, 2015 annualized. December 31, 2015 represents 12 months ended December 31, 2015.

**Extensions**

In certain circumstances we will grant obligors one-month payment extensions to assist them with temporary cash flow problems. In general, an obligor would not be entitled to more than two such extensions in any 12-month period and no more than six over the life of the contract. The only modification of terms is to advance the obligor's next due date by one month and extend the maturity date of the receivable by one month. In some cases, a two-month extension may be granted. There are no other concessions such as a reduction in interest rate, forgiveness of principal or of accrued interest. Accordingly, we consider such extensions to be insignificant delays in payments rather than troubled debt restructurings.

The basic question in deciding to grant an extension is whether or not we will (a) be delaying the inevitable repossession and liquidation or (b) risk losing the vehicle as a result of not being able to locate the obligor and vehicle. In both of those situations, the loss would likely be higher than if the vehicle had been repossessed without the extension. The benefits of granting an extension include minimizing current losses and delinquencies, minimizing lifetime losses, getting the obligor's account current (or close to it) and building goodwill with the obligor so that he might prioritize us over other creditors on future payments. Our servicing staff are trained to identify when a past due obligor is facing a temporary problem that may be resolved with an extension. In most cases, the extension will be granted in conjunction with our receiving a past due payment (and where allowed by law, a nominal fee, applied to the loan as a partial payment) from the obligor, thereby indicating an additional monetary and psychological commitment to the contract on the obligor's part.

The credit assessment for granting an extension is initially made by our collector, who bases the recommendation on the collector's discussions with the obligor. In such assessments the collector will consider, among other things, the following factors: (1) the reason the obligor has fallen behind in payment; (2) whether or not the reason for the delinquency is temporary, and if it is, have conditions changed such that the obligor can begin making regular monthly payments again after the extension; (3) the obligor's past payment history, including past extensions if applicable; and (4) the obligor's willingness to communicate and cooperate on resolving the delinquency. If the collector believes the obligor is a good candidate for an extension, he must obtain approval from his supervisor, who will review the same factors stated above prior to offering the extension to the obligor. After receiving an extension, an account remains subject to our normal policies and procedures for interest accrual, reporting delinquency and recognizing charge-offs.

We believe that a prudent extension program is an integral component to mitigating losses in our portfolio of sub-prime automobile receivables. The table below summarizes the status, as of September 30, 2016, for accounts that received extensions from 2008 through 2014 (2016 extension data are not included at this time due to insufficient passage of time for meaningful evaluation of results):

| Period of Extension | # Extensions Granted | Active or Paid Off at September 30, 2016 | % Active or Paid Off at September 30, 2016 | Charged Off > 6 Months After Extension | % Charged Off > 6 Months After Extension | Charged Off <= 6 Months After Extension | % Charged Off <= 6 Months After Extension | Avg Months to Charge Off Post Extension |
|---------------------|----------------------|--|--|--|--|---|---|---|
| 2008                | 35,588               | 10,713                                   | 30.1%                                      | 20,054                                 | 56.4%                                    | 4,819                                   | 13.5%                                     | 19                                      |
| 2009                | 32,226               | 10,281                                   | 31.9%                                      | 16,162                                 | 50.2%                                    | 5,783                                   | 17.9%                                     | 17                                      |
| 2010                | 26,167               | 12,179                                   | 46.5%                                      | 11,989                                 | 45.8%                                    | 1,999                                   | 7.6%                                      | 19                                      |
| 2011                | 18,786               | 11,013                                   | 58.6%                                      | 6,841                                  | 36.4%                                    | 932                                     | 5.0%                                      | 19                                      |
| 2012                | 18,783               | 11,577                                   | 61.6%                                      | 6,410                                  | 34.1%                                    | 796                                     | 4.2%                                      | 17                                      |
| 2013                | 23,398               | 13,291                                   | 56.8%                                      | 9,131                                  | 39.0%                                    | 976                                     | 4.2%                                      | 17                                      |
| 2014                | 25,773               | 16,017                                   | 62.1%                                      | 8,930                                  | 34.6%                                    | 826                                     | 3.2%                                      | 15                                      |
| 2015                | 53,319               | 43,351                                   | 81.3%                                      | 8,886                                  | 16.7%                                    | 1,082                                   | 2.0%                                      | 10                                      |

*Table excludes extensions on portfolios serviced for third parties.*

We view these results as a confirmation of the effectiveness of our extension program. For example, of the accounts granted extensions in 2012, 61.6% were either paid in full or active and performing at September 30, 2016. Each of these successful accounts represent continued payments of interest and principal (including payment in full in many cases), where without the extension we likely would have incurred a substantial loss and no interest revenue subsequent to the extension.

For the extension accounts that ultimately charge off, we consider any that charged off more than six months after the extension to be at least partially successful. For example, of the accounts granted extensions in 2012 that subsequently charged off, such charge offs occurred, on average, 17 months after the extension, indicating that even in the cases of an ultimate loss, the obligor serviced the account with additional payments of principal and interest.

Additional information about our extensions is provided in the tables below:

|   | Nine Months Ended September 30, |         | Year Ended        |
|---|---------------------------------|---------|-------------------|
|   | 2016                            | 2015    | December 31, 2015 |
| Average number of extensions granted per month          | 5,861                           | 4,276   | 4,443             |
| Average number of outstanding accounts                  | 160,952                         | 134,057 | 137,306           |
| Average monthly extensions as % of average outstandings | 3.6%                            | 3.2%    | 3.2%              |

*Table excludes portfolios originated and owned by third parties.*

|   | September 30, 2016     |                   | September 30, 2015  |                   | December 31, 2015   |                   |
|---|------------------------|-------------------|---------------------|-------------------|---------------------|-------------------|
|   | Number of Contracts    | Amount            | Number of Contracts | Amount            | Number of Contracts | Amount            |
|   | (Dollars in thousands) |                   |                     |                   |                     |                   |
| Contracts with one extension                                      | 32,527                 | \$ 448,481        | 25,946              | \$ 350,169        | 28,466              | \$ 384,064        |
| Contracts with two extensions                                     | 15,123                 | 202,846           | 10,359              | 136,634           | 11,763              | 156,840           |
| Contracts with three extensions                                   | 7,424                  | 98,438            | 3,901               | 50,652            | 4,567               | 59,255            |
| Contracts with four extensions                                    | 3,110                  | 39,773            | 1,066               | 13,350            | 1,401               | 17,734            |
| Contracts with five extensions                                    | 987                    | 11,879            | 192                 | 2,064             | 301                 | 3,351             |
| Contracts with six extensions                                     | 252                    | 2,992             | 44                  | 443               | 50                  | 521               |
|   | <u>59,423</u>          | <u>\$ 804,409</u> | <u>41,508</u>       | <u>\$ 553,312</u> | <u>46,548</u>       | <u>\$ 621,765</u> |
| Managed portfolio (excluding originated and owned by 3rd parties) | 167,629                | \$ 2,291,854      | 143,057             | \$ 1,940,546      | 149,138             | \$ 2,031,099      |

Table excludes portfolios originated and owned by third parties.

### Non-Accrual Receivables

It is not uncommon for our obligors to fall behind in their payments. However, with the diligent efforts of our Servicing staff and systems for managing our collection efforts, we regularly work with our customers to resolve delinquencies. Our staff are trained to employ a counseling approach to assist our customers with their cash flow management skills and help them to prioritize their payment obligations in order to avoid losing their vehicle to repossession. Through our experience, we have learned that once a customer becomes greater than 90 days past due, it is not likely that the delinquency will be resolved and will ultimately result in a charge-off. As a result, we do not recognize any interest income for contracts that are greater than 90 days past due.

If a contract exceeds the 90 days past due threshold at the end of one period, and then makes the necessary payments such that it becomes less than or equal to 90 days delinquent at the end of a subsequent period, it would be restored to full accrual status for our financial reporting purposes. At the time a contract is restored to full accrual in this manner, there can be no assurance that full repayment of interest and principal will ultimately be made. However, we monitor each obligor's payment performance and are aware of the severity of his delinquency at any time. The fact that the delinquency has been reduced below the 90-day threshold is a positive indicator. Should the contract again exceed the 90-day delinquency level at the end of any reporting period, it would again be reflected as a non-accrual account.

Our policy for placing a contract on non-accrual status is independent of our policy to grant an extension. In practice, it would be an uncommon circumstance where an extension was granted and the account remained in a non-accrual status, since the goal of the extension is to bring the contract current (or nearly current).

### Liquidity and Capital Resources

Our business requires substantial cash to support our purchases of automobile contracts and other operating activities. Our primary sources of cash have been cash flows from the proceeds from term securitization transactions and other sales of automobile contracts, amounts borrowed under various revolving credit facilities (also sometimes known as warehouse credit facilities), servicing fees on portfolios of automobile contracts previously sold in securitization transactions or serviced for third parties, customer payments of principal and interest on finance receivables, fees for origination of automobile contracts, and releases of cash from securitization transactions and their related spread accounts. Our primary uses of cash have been the purchases of automobile contracts, repayment of amounts borrowed under lines of credit, securitization transactions and otherwise, operating expenses such as employee, interest, occupancy expenses and other general and administrative expenses, the establishment of spread accounts and initial overcollateralization, if any, the increase of credit enhancement to required levels in securitization transactions, and income taxes. There can be no assurance that internally generated cash will be sufficient to meet our cash demands. The sufficiency of internally generated cash will depend on the performance of securitized pools (which determines the level of releases from those pools and their related spread accounts), the rate of expansion or contraction in our managed portfolio, and the terms upon which we are able to acquire and borrow against automobile contracts.

Net cash provided by operating activities for the nine-month period ended September 30, 2016 was \$159.1 million, an increase of \$21.1 million, compared to net cash provided by operating activities for the nine-month period ended September 30, 2015 of \$138.0 million. Cash provided by operating activities is significantly affected by our net income before provisions for credit losses. For the nine months ended September 30, 2016, our net income excluding provisions for credit losses was \$156.7 million, or \$24.5 million more than our net income excluding provisions for credit losses for the nine months ended September 30, 2015.

Net cash used in investing activities for the nine-month period ended September 30, 2016 was \$390.9 million compared to net cash used in investing activities of \$418.5 million in the prior year period. Cash provided by investing activities primarily results from principal payments and other proceeds received on finance receivables held for investment and increases in restricted cash. Cash used in investing activities generally relates to purchases of automobile contracts. Purchases of finance receivables held for investment were \$873.5 million and \$791.3 million during the first nine months of 2016 and 2015, respectively.

Net cash provided by financing activities for the nine months ended September 30, 2016 was \$224.0 million compared to net cash provided by financing activities of \$283.6 million in the prior year period. Cash provided by financing activities is primarily related to the issuance of securitization trust debt, reduced by the amount of repayment of securitization trust debt and net proceeds or repayments on our warehouse lines of credit and other debt. In the first nine months of 2016, we issued \$980.7 million in new securitization trust debt compared to \$795.0 million in the same period of 2015. In addition, we repaid \$625.5 million in securitization trust debt in the nine months ended September 30, 2016 compared to repayments of securitization trust debt of \$490.0 million in the prior year period. In the nine months ended September 30, 2016, we had net repayments on warehouse lines of credit of \$112.7 million, compared to net repayments of \$9.9 million in the prior year's period.

We purchase automobile contracts from dealers for a cash price approximately equal to their principal amount, adjusted for an acquisition fee which may either increase or decrease the automobile contract purchase price. Those automobile contracts generate cash flow, however, over a period of years. As a result, we have been dependent on warehouse credit facilities to purchase automobile contracts, and on the availability of cash from outside sources in order to finance our continuing operations, as well as to fund the portion of automobile contract purchase prices not financed under revolving warehouse credit facilities.

The acquisition of automobile contracts for subsequent financing in securitization transactions, and the need to fund spread accounts and initial overcollateralization, if any, and increase credit enhancement levels when those transactions take place, results in a continuing need for capital. The amount of capital required is most heavily dependent on the rate of our automobile contract purchases, the required level of initial credit enhancement in securitizations, and the extent to which the previously established trusts and their related spread accounts either release cash to us or capture cash from collections on securitized automobile contracts. Of those, the factor most subject to our control is the rate at which we purchase automobile contracts.

We are and may in the future be limited in our ability to purchase automobile contracts due to limits on our capital. As of September 30, 2016, we had unrestricted cash of \$11.5 million and \$216.3 million aggregate available borrowings under our three warehouse credit facilities (assuming the availability of sufficient eligible collateral). As of September 30, 2016 we had approximately \$25.4 million of such eligible collateral. During the nine-month period ended September 30, 2016, we completed three securitizations aggregating \$980.7 million of notes sold. Our plans to manage our liquidity include maintaining our rate of automobile contract purchases at a level that matches our available capital, and, as appropriate, minimizing our operating costs. If we are unable to complete such securitizations, we may be unable to increase our rate of automobile contract purchases, in which case our interest income and other portfolio related income could decrease.

Our liquidity will also be affected by releases of cash from the trusts established with our securitizations. While the specific terms and mechanics of each spread account vary among transactions, our securitization agreements generally provide that we will receive excess cash flows, if any, only if the amount of credit enhancement has reached specified levels and the delinquency or net losses related to the automobile contracts in the pool are below certain predetermined levels. In the event delinquencies or net losses on the automobile contracts exceed such levels, the terms of the securitization may require increased credit enhancement to be accumulated for the particular pool. There can be no assurance that collections from the related trusts will continue to generate sufficient cash. Moreover, certain of our retained interests in securitization transactions and their related spread accounts are pledged as collateral to our residual interest financing and cash releases from these transactions will be used to repay the financings.

One of our securitization transactions, our warehouse credit facilities and our residual interest contain various financial covenants requiring certain minimum financial ratios and results. Such covenants include maintaining minimum levels of liquidity and net worth and not exceeding maximum leverage levels. In addition, certain of our debt agreements other than our term securitizations contain cross-default provisions. Such cross-default provisions would allow the respective creditors to declare a default if an event of default occurred with respect to other indebtedness of ours, but only if such other event of default were to be accompanied by acceleration of such other indebtedness. As of September 30, 2016, we were in compliance with all such financial covenants.

We have and will continue to have a substantial amount of indebtedness. At September 30, 2016, we had approximately \$2,176.3 million of debt outstanding. Such debt consisted primarily of \$2,073.4 million of securitization trust debt and \$81.7 million of warehouse lines of credit. Our securitization trust debt and our warehouse lines of credit have increased by \$169.8 million, and \$34.7 million, respectively since September 30, 2015 (each net of deferred financing costs). As of September 30, 2016 our debt also included \$6.9 million of residual interest financing and \$14.4 million in subordinated renewable notes. We are currently offering the subordinated notes to the public on a continuous basis, and such notes have maturities that range from six months to 10 years.

Our recent operating results include pre-tax earnings of \$37.0 million for the nine months ended September 30, 2016 and \$61.4 million, \$52.2 million, \$37.2 million and \$9.2 for the years ended December 31, 2015, December 31, 2014, December 31, 2013 and December 31, 2012, respectively. Those periods were preceded by pre-tax losses of \$14.5 million and \$16.2 million in 2011 and 2010, respectively. We believe that our 2011 and 2010 results were materially and adversely affected by the disruption in the capital markets that began in the fourth quarter of 2007, by the recession that began in December 2007, and by related high levels of unemployment.

Although we believe we are able to service and repay our debt, there is no assurance that we will be able to do so. If our plans for future operations do not generate sufficient cash flows and earnings, our ability to make required payments on our debt would be impaired. If we fail to pay our indebtedness when due, it could have a material adverse effect on us and may require us to issue additional debt or equity securities.

### **Forward Looking Statements**

This report on Form 10-Q includes certain “forward-looking statements.” Forward-looking statements may be identified by the use of words such as “anticipates,” “expects,” “plans,” “estimates,” or words of like meaning. Our provision for credit losses is a forward-looking statement, as it is dependent on our estimates as to future chargeoffs and recovery rates. Factors that could affect charge-offs and recovery rates include changes in the general economic climate, which could affect the willingness or ability of obligors to pay pursuant to the terms of automobile contracts, changes in laws respecting consumer finance, which could affect our ability to enforce rights under automobile contracts, and changes in the market for used vehicles, which could affect the levels of recoveries upon sale of repossessed vehicles. Factors that could affect our revenues in the current year include the levels of cash releases from existing pools of automobile contracts, which would affect our ability to purchase automobile contracts, the terms on which we are able to finance such purchases, the willingness of dealers to sell automobile contracts to us on the terms that we offer, and the terms on which and whether we are able to complete term securitizations once automobile contracts are acquired. Factors that could affect our expenses in the current year include competitive conditions in the market for qualified personnel and interest rates (which affect the rates that we pay on notes issued in our securitizations).

### **Item 4. Controls and Procedures**

We maintain a system of internal controls and procedures designed to provide reasonable assurance as to the reliability of our published financial statements and other disclosures included in this report. As of the end of the period covered by this report, we evaluated the effectiveness of the design and operation of such disclosure controls and procedures. Based upon that evaluation, the principal executive officer (Charles E. Bradley, Jr.) and the principal financial officer (Jeffrey P. Fritz) concluded that the disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, material information relating to us that is required to be included in our reports filed under the Securities Exchange Act of 1934. There has been no change in our internal controls over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. *Legal Proceedings*

The information provided under the caption "Legal Proceedings," Note 8 to the Unaudited Condensed Consolidated Financial Statements, included in Part I of this report, is incorporated herein by reference.

### Item 1A. *Risk Factors*

We remind the reader that risk factors are set forth in Item 1A of our report on Form 10-K, filed with the U.S. Securities and Exchange Commission on March 9, 2016. Where we are aware of material changes to such risk factors as previously disclosed, we set forth below an updated discussion of such risks. The reader should note that the other risks identified in our report on Form 10-K remain applicable.

#### *We have substantial indebtedness.*

We have and will continue to have a substantial amount of indebtedness. At September 30, 2016, we had approximately \$2,176.3 million of debt outstanding. Such debt consisted primarily of \$2,073.4 million of securitization trust debt and \$81.7 million of warehouse lines of credit. Our securitization trust debt and our warehouse lines of credit have increased by \$169.8 million, and \$34.7 million, respectively since September 30, 2015 (each net of deferred financing costs). As of September 30, 2016 our debt also included \$6.9 million of residual interest financing and \$14.4 million in subordinated renewable notes. We are currently offering the subordinated notes to the public on a continuous basis, and such notes have maturities that range from six months to 10 years.

Our substantial indebtedness could adversely affect our financial condition by, among other things:

- increasing our vulnerability to general adverse economic and industry conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing amounts available for working capital, capital expenditures and other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage compared to our competitors that have less debt; and
- limiting our ability to borrow additional funds.

Although we believe we are able to service and repay such debt, there is no assurance that we will be able to do so. If we do not generate sufficient operating profits, our ability to make required payments on our debt would be impaired. Failure to pay our indebtedness when due could have a material adverse effect.

### Forward-Looking Statements

Discussions of certain matters contained in this report may constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Exchange Act, and as such, may involve risks and uncertainties. These forward-looking statements relate to, among other things, expectations of the business environment in which we operate, projections of future performance, perceived opportunities in the market and statements regarding our mission and vision. You can generally identify forward-looking statements as statements containing the words "will," "would," "believe," "may," "could," "expect," "anticipate," "intend," "estimate," "assume" or other similar expressions. Our actual results, performance and achievements may differ materially from the results, performance and achievements expressed or implied in such forward-looking statements. The discussion under "Risk Factors" identifies some of the factors that might cause such a difference, including the following:

- changes in general economic conditions;
- our ability or inability to obtain necessary financing, and the terms of any such financing
- changes in interest rates, especially as applicable to securitization trust debt;
- our ability to generate sufficient operating and financing cash flows;
- competition;
- level of future provisioning for receivables losses;

- the levels of actual losses on receivables; and
- regulatory requirements.

Forward-looking statements are not guarantees of performance. They involve risks, uncertainties and assumptions. Actual results may differ from expectations due to many factors beyond our ability to control or predict, including those described herein, and in documents incorporated by reference in this report. For these statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

We undertake no obligation to publicly update any forward-looking information. You are advised to consult any additional disclosure we make in our periodic reports filed with the SEC.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

During the three months ended September 30, 2016, we repurchased 421,026 shares from existing shareholders, as reflected in the table below.

**Issuer Purchases of Equity Securities**

| <u>Period(1)</u> | <u>Total<br/>Number of<br/>Shares<br/>Purchased</u> | <u>Average<br/>Price Paid<br/>Share</u> | <u>Total Number<br/>of Shares<br/>Purchased<br/>as Part of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</u> | <u>Approximate<br/>Dollar Value<br/>of Shares that<br/>May Yet be<br/>Purchased Under<br/>the Plans or<br/>Programs (2)</u> |
|------------------|---|---|---|---|
| July 2016        | 230,659   | \$ 3.94                                 | 230,659   | \$ 7,829,712  |
| August 2016      | 40,153  | \$ 4.06                                 | 40,153  | \$ 7,666,641  |
| September 2016   | 150,214   | \$ 4.12                                 | 150,214   | \$ 7,047,595  |
| Total            | <u>421,026</u>                                      | <u>\$ 4.01</u>                          | <u>421,026</u>  |   |

(1) Each monthly period is the calendar month.

(2) Through September 30, 2016, our board of directors had authorized the purchase of up to \$54.5 million of our outstanding securities, under a program first announced in our annual report for the year 2002, filed on March 26, 2003. All purchases described in the table above were under the program announced in March 2003, which has no fixed expiration date. Our board of directors in May 2016 increased the aggregate authorization by \$10 million from \$44.5 million to \$54.5 million.

**Item 6. Exhibits**

The Exhibits listed below are filed with this report.

|         |  |
|---------|--|
| 4.14    | Instruments defining the rights of holders of long-term debt of certain consolidated subsidiaries of the registrant are omitted pursuant to the exclusion set forth in subdivisions (b)(iv)(iii)(A) and (b)(v) of Item 601 of Regulation S-K (17 CFR 229.601). The registrant agrees to provide copies of such instruments to the United States Securities and Exchange Commission upon request. |
| 31.1    | Rule 13a-14(a) Certification of the Chief Executive Officer of the registrant.   |
| 31.2    | Rule 13a-14(a) Certification of the Chief Financial Officer of the registrant.   |
| 32      | Section 1350 Certifications.*  |
| 101.INS | XBRL Instances Document  |
| 101.SCH | XBRL Taxonomy Extension Schema Document  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document   |

\* These Certifications shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. These Certifications shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act, except to the extent that the registration statement specifically states that such Certifications are incorporated therein.

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 31, 2016

CONSUMER PORTFOLIO SERVICES, INC.  
(Registrant)

By: /s/ CHARLES E. BRADLEY, JR.  
Charles E. Bradley, Jr.  
*President and Chief Executive Officer*  
(Principal Executive Officer)

Date: October 31, 2016

By: /s/ JEFFREY P. FRITZ  
Jeffrey P. Fritz  
*Executive Vice President and Chief Financial Officer*  
(Principal Financial Officer)

## CERTIFICATION

I, Charles E. Bradley, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended September 30, 2016 of Consumer Portfolio Services, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 31, 2016

/s/ CHARLES E. BRADLEY, JR.

Charles E. Bradley, Jr. Chief Executive Officer

## CERTIFICATION

I, Jeffrey P. Fritz, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarterly period ended September 30, 2016 of Consumer Portfolio Services, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the period presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: October 31, 2016

/s/ JEFFREY P. FRITZ

Jeffrey P. Fritz, Chief Financial Officer

**Certification Pursuant To  
18 U.S.C. Section 1350,  
As Adopted Pursuant To  
Section 906 of The Sarbanes-Oxley Act Of 2002**

In connection with the Quarterly Report on Form 10-Q of Consumer Portfolio Services, Inc. (the "Company") for the quarterly period ended September 30, 2016, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Charles E. Bradley, Jr., as Chief Executive Officer of the Company, and Jeffrey P. Fritz, as Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: October 31, 2016

/s/ CHARLES E. BRADLEY, JR.

Charles E. Bradley, Jr.  
Chief Executive Officer

/s/ JEFFREY P. FRITZ

Jeffrey P. Fritz  
Chief Financial Officer

This certification accompanies each Report pursuant to § 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of §18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.