

CONSUMER PORTFOLIO SERVICES INC  
Form 10-K  
March 09, 2016

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**FORM 10-K**

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2015

**Commission file number: 001-14116**

**CONSUMER PORTFOLIO SERVICES, INC.**

(Exact name of registrant as specified in its charter)

California 33-0459135  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

3800 Howard Hughes Pkwy, Las Vegas, NV 89169  
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (949) 753-6800

Securities registered pursuant to Section 12(b) of the Act:

| <u>Title of Each Class</u> | <u>Name of Each Exchange on Which Registered</u> |
|----------------------------|--|
| Common Stock, no par value | The Nasdaq Stock Market LLC (Global Market)      |

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes      No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Yes      No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer      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

The aggregate market value of the 21,024,763 shares of the registrant's common stock held by non-affiliates as of the date of filing of this report, based upon the closing price of the registrant's common stock of \$6.25 per share reported by Nasdaq as of June 30, 2015, was approximately \$131,404,769. For purposes of this computation, a registrant sponsored pension plan and all directors and executive officers are deemed to be affiliates. Such determination is not an admission that such plan, directors and executive officers are, in fact, affiliates of the registrant. The number of shares of the registrant's Common Stock outstanding on March 4, 2016 was 25,186,261.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

The proxy statement for registrant's 2016 annual shareholders meeting is incorporated by reference into Part III hereof.

## TABLE OF CONTENTS

**PART I**

|                                      |                |
|--------------------------------------|----------------|
| Item 1. Business                     | 1              |
| Item 1A. Risk Factors                | 14             |
| Item 1B. Unresolved Staff Comments   | not applicable |
| Item 2. Properties                   | 24             |
| Item 3. Legal Proceedings            | 24             |
| Item 4. Mine Safety Disclosures      | not applicable |
| Executive Officers of the Registrant | 25             |

**PART II**

|   |    |
|---|----|
| Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities | 27 |
| Item 6. Selected Financial Data   | 28 |
| Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations                         | 31 |
| Item 7A. Quantitative and Qualitative Disclosures About Market Risk   | 49 |
| Item 8. Financial Statements and Supplementary Data   | 50 |
| Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure                          | 50 |
| Item 9A. Controls and Procedures  | 50 |
| Item 9B. Other Information  | 50 |

**PART III**

|   |    |
|---|----|
| Item 10. Directors, Executive Officers and Corporate Governance   | 51 |
| Item 11. Executive Compensation   | 51 |
| Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters | 51 |
| Item 13. Certain Relationships and Related Transactions, and Director Independence                      | 51 |
| Item 14. Principal Accountant Fees and Services   | 51 |

**PART IV**

|  |    |
|--|----|
| Item 15. Exhibits, Financial Statement Schedules | 52 |
|--|----|



PART I

Item 1. Business

Overview

We are a specialty finance company. 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 the customers of dealers who have limited credit histories or past credit problems, who we refer to as sub-prime customers. 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 acquired installment purchase contracts in four merger and acquisition transactions, and purchased or originated immaterial amounts 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. We consist of Consumer Portfolio Services, Inc. and subsidiaries (collectively, "we," "us," "CPS" or "the Company"). From inception through December 31, 2015, we have purchased a total of approximately \$12.4 billion of automobile contracts from dealers. In addition, we acquired a total of approximately \$822.3 million of automobile contracts in mergers and acquisitions in 2002, 2003, 2004 and, most recently in September 2011. The September 2011 acquisition consisted of approximately \$217.8 million of automobile contracts that we purchased from Fireside Bank of Pleasanton, California. In 2004 and 2009, we were appointed as a third-party servicer for certain portfolios of automobile contracts originated and owned by non-affiliated entities. From 2008 through 2010, our managed portfolio decreased each year due to our strategy of limiting contract purchases to conserve our liquidity during the financial crisis and resulting recession, as discussed further below. However, since October 2009, we have gradually increased contract purchases, which, in turn, has resulted in increases in our managed portfolio. Contract purchase volumes and managed portfolio levels for the five years ended December 31, 2015 are shown in the table below:

**Contract Purchases and Outstanding Managed Portfolio**

|      | \$ in thousands               |                             |
|------|-------------------------------|-----------------------------|
| Year | Contracts Purchased in Period | Managed Portfolio at Period |

|      |           | End       |
|------|-----------|-----------|
| 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 |

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.

We direct our marketing efforts primarily to dealers, rather than to consumers. We establish relationships with dealers through our employee marketing representatives, who contact prospective dealers to explain our automobile contract purchase programs, and thereafter provide dealer training and support services. Our marketing representatives represent us exclusively. They may be located in our Irvine branch, in our Las Vegas branch, or in the field, in which case they work from their homes and support dealers in their geographic area. Our marketing representatives present dealers with a marketing package, which includes our promotional material containing the terms offered by us for the purchase of automobile contracts, a copy of our standard-form dealer agreement, and required documentation relating to automobile contracts. As of December 31, 2015, we had 109 marketing representatives and in that month we received applications from 7,941 dealers in 47 states. As of December 31, 2015, approximately 67% of our active dealers were franchised new car dealers that sell both new and used vehicles, and the remainder were independent used car dealers. For the year ended December 31, 2015, approximately 78% of the automobile contracts purchased under our programs consisted of financing for used cars and 22% consisted of financing for new cars, as compared to 84% financing for used cars and 16% for new cars in the year ended December 31, 2014.

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. The subsidiary in turn issues (or contributes to a trust that issues) asset-backed securities, which are purchased by institutional investors. Since 1994, we have completed 68 term securitizations of approximately \$10.2 billion in contracts. We depend upon the availability of short-term warehouse credit facilities as interim financing for our contract purchases prior to the time we pool those contracts for a securitization. From February 2011 through October 2015 we maintained two \$100 million revolving warehouse credit facilities. In November 2015 we added a third \$100 million facility.

### Sub-Prime Auto Finance Industry

Automobile financing is the second largest consumer finance market in the United States. The automobile finance industry can be considered a continuum where participants choose to provide financing to consumers in various segments of the spectrum of creditworthiness depending on each participant's business strategy. We operate in a segment of the spectrum that is frequently referred to as sub-prime since we provide financing to less credit-worthy borrowers at higher rates of interest than more credit-worthy borrowers are likely to obtain.

Traditional automobile finance companies, such as banks, their subsidiaries, credit unions and captive finance subsidiaries of automobile manufacturers, generally lend to the most creditworthy, or so-called prime, borrowers, although some traditional lenders are significant participants in the sub-prime segment in which we operate. Historically, independent companies specializing in sub-prime automobile financing and subsidiaries of larger financial services companies have competed in the sub-prime segment which we believe remains highly fragmented, with no single company having a dominant position in the market.

Economic conditions of uncertainty have from time to time negatively affected our industry. Notably, and most recently, throughout 2008 and 2009 there was reduced demand for asset-backed securities secured by consumer finance receivables, including sub-prime automobile receivables. Over roughly that same period, lenders who previously provided short-term warehouse financing for sub-prime automobile finance companies such as ours were reluctant to provide such short-term financing due to the uncertainty regarding the prospects of obtaining long-term financing through the issuance of asset-backed securities. In addition, many capital market participants such as investment banks, financial guaranty providers and institutional investors who previously played a role in the sub-prime auto finance industry withdrew from the industry, or in some cases, ceased to do business. Finally, broad economic weakness and high levels of unemployment during 2008, 2009 and thereafter caused many of the obligors under our receivables to be less willing or able to pay, resulting in higher delinquencies, charge-offs and losses. Each of these factors adversely affected our results of operations in the period 2008 through 2011. Since October 2009, however, improvements in the capital markets have allowed us to obtain new short-term credit facilities, and to regularly access long-term funding through the issuance of asset-backed securities.



## Our Operations

Our automobile financing programs are designed to serve sub-prime customers, who generally have limited credit histories or past credit problems. Because we serve customers who are unable to meet certain credit standards, we incur greater risks, and generally receive interest rates higher than those charged in the prime credit market. We also sustain a higher level of credit losses because of the higher risk customers we serve.

## Originations

When a retail automobile buyer elects to obtain financing from a dealer, the dealer takes a credit application to submit to its financing sources. Typically, a dealer will submit the buyer's application to more than one financing source for review. We believe the dealer's decision to choose a financing source is based primarily on: (i) the interest rate and monthly payment made available to the dealer's customer; (ii) any fees to be charged to (or paid to) the dealer by the financing source; (iii) the timeliness, consistency and predictability of response; (iv) funding turnaround time; (v) any conditions to purchase; and (vi) the financial stability of the financing source. Dealers can send credit applications to us by entering the necessary data on our website or through one of two third-party application aggregators. For the year ended December 31, 2015, we received approximately 78% of all applications through DealerTrack (the industry leading dealership application aggregator), 3% via our website and 19% via another aggregator, Route One. Our automated application decisioning system produced our initial decision within seconds on approximately 98% of those applications.

Upon receipt of information from a dealer, we immediately order two credit reports to document the buyer's credit history. If, upon review by our proprietary automated decisioning system, or in some cases, one of our credit analysts, we determine that the automobile contract meets our underwriting criteria, we advise the dealer of our decision to approve the contract and the terms under which we will purchase it. In some cases where we don't grant an approval, we may suggest alternatives from the terms proposed by the dealer or request and review further information from the dealer.

Dealers with which we do business are under no obligation to submit any automobile contracts to us, nor are we obligated to purchase any automobile contracts from them. During the year ended December 31, 2015, no dealer accounted for more than 0.75% of the total number of automobile contracts we purchased. The following table sets forth the geographical sources of the automobile contracts we purchased (based on the addresses of the customers as stated on our records) during the years ended December 31, 2015 and 2014.

|                | Contracts Purchased During the Year Ended |             |                   |             |
|----------------|---|-------------|-------------------|-------------|
|                | December 31, 2015                         |             | December 31, 2014 |             |
|                | Number                                    | Percent (1) | Number            | Percent (1) |
| California     | 5,775                                     | 8.9%        | 5,163             | 8.7%        |
| Texas          | 5,077                                     | 7.9%        | 5,926             | 10.0%       |
| Ohio           | 4,227                                     | 6.5%        | 3,379             | 5.7%        |
| Florida        | 3,397                                     | 5.3%        | 2,951             | 5.0%        |
| Georgia        | 3,361                                     | 5.2%        | 2,611             | 4.4%        |
| North Carolina | 3,167                                     | 4.9%        | 2,263             | 3.8%        |
| Other States   | 39,553                                    | 61.3%       | 36,983            | 62.4%       |
| Total          | 64,557                                    | 100.0%      | 59,276            | 100.0%      |

(1) Percentages may not total to 100.0% due to rounding.

The following table sets forth the geographic concentrations of our outstanding managed portfolio as of December 31, 2015 and 2014.

|                                    | December 31, 2015 |             | December 31, 2014 |             |
|------------------------------------|-------------------|-------------|-------------------|-------------|
|                                    | Amount            | Percent (1) | Amount            | Percent (1) |
| State based on obligor's residence | (\$ in millions)  |             |                   |             |
| California                         | \$201.7           | 9.9%        | \$178.8           | 10.9%       |
| Texas                              | 182.0             | 9.0%        | 166.8             | 10.1%       |
| Ohio                               | 113.0             | 5.6%        | 81.8              | 5.0%        |

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|            |           |        |           |        |
|------------|-----------|--------|-----------|--------|
| Georgia    | 108.8     | 5.4%   | 83.4      | 5.1%   |
| Florida    | 98.9      | 4.9%   | 78.3      | 4.8%   |
| All others | 1,326.7   | 65.3%  | 1,054.8   | 64.2%  |
| Total      | \$2,031.1 | 100.0% | \$1,643.9 | 100.0% |

*(1) Percentages may not total to 100.0% due to rounding.*

We purchase automobile contracts from dealers at a price generally computed as the total amount financed under the automobile contracts, adjusted for an acquisition fee, which may either increase or decrease the automobile contract purchase price we pay. The amount of the acquisition fee, and whether it results in an increase or decrease to the automobile contract purchase price, is based on the perceived credit risk of and, in some cases, the interest rate on the automobile contract. The following table summarizes the average net acquisition fees we charged dealers and the weighted average annual percentage rate on our purchased contracts for the periods shown:

|   | 2015   | 2014   | 2013   | 2012   | 2011    |
|---|--------|--------|--------|--------|---------|
| Average net acquisition fee amount                  | \$56   | \$162  | \$418  | \$836  | \$1,155 |
| Average net acquisition fee as % of amount financed | 0.3 %  | 1.0 %  | 2.7 %  | 5.5 %  | 7.4 %   |
| Weighted average annual percentage interest rate    | 19.3 % | 19.6 % | 20.1 % | 20.3 % | 20.1 %  |

We believe that levels of acquisition fees are determined partially by competition in the marketplace, which has increased over the periods presented, and also by our pricing strategy. Our pricing strategy is driven by our objectives for new contract purchase quantities and yield.

We offer eight different financing programs to our dealership customers, and price each program according to the relative credit risk. Our programs cover a wide band of the credit spectrum and are labeled as follows:

**Bravo** - this program accommodates an applicant with significant past non-performing credit including recent derogatory credit. Advance rates are lowest of all of our programs to offset the greater risk. To offset the low up-front advance to the dealer, we agree to pay the dealer a portion of future payments we receive from the obligor, depending on loan performance. The Bravo program was introduced in November of 2015 and as of December 31, 2015, only a few such contracts have been acquired.

**First Time Buyer** – This program accommodates an applicant who has limited significant past credit history, such as a previous auto loan. Since the applicant has limited credit history, the contract interest rate and dealer acquisition fees tend to be higher, and the loan amount, loan-to-value ratio, down payment and payment-to-income ratio requirements tend to be more restrictive compared to our other programs.

**Mercury / Delta** – This program accommodates an applicant who may have had significant past non-performing credit including recent derogatory credit. As a result, the contract interest rate and dealer acquisition fees tend to be higher, and the loan amount, loan-to-value ratio, down payment, and payment-to-income ratio requirements tend to be more restrictive compared to our other programs.

**Standard** – This program accommodates an applicant who may have significant past non-performing credit, but who has also exhibited some performing credit in their history. The contract interest rate and dealer acquisition fees are comparable to the First Time Buyer and Mercury/Delta programs, but the loan amount and loan-to-value ratio requirements are somewhat less restrictive.

Alpha – This program accommodates applicants who may have a discharged bankruptcy, but who have also exhibited performing credit. In addition, the program allows for homeowners who may have had other significant non-performing credit in the past. The contract interest rate and dealer acquisition fees are lower than the Standard program, down payment and payment-to-income ratio requirements are somewhat less restrictive.

Alpha Plus – This program accommodates applicants with past non-performing credit, but with a stronger history of recent performing credit, such as auto or mortgage related credit, and higher incomes than the Alpha program. Contract interest rates and dealer acquisition fees are lower than the Alpha program.

Super Alpha – This program accommodates applicants with past non-performing credit, but with a somewhat stronger history of recent performing credit, including auto or mortgage related credit, and higher incomes than the Alpha Plus program. Contract interest rates and dealer acquisition fees are lower, and the maximum loan amount is somewhat higher, than the Alpha Plus program.

Preferred - This program accommodates applicants with past non-performing credit, but who demonstrate a somewhat stronger history of recent performing credit than the Super Alpha program. Contract interest rates and dealer acquisition fees are lower, and the maximum loan amount is somewhat higher than the Super Alpha program.

Our upper credit tier products, which are our Preferred, Super Alpha, Alpha Plus and Alpha programs, accounted for approximately 77% of our new contract originations in 2015, 74% in 2014 and 74% in 2013, measured by aggregate amount financed.

The following table identifies the credit program, sorted from highest to lowest credit quality, under which we purchased automobile contracts during the years ended December 31, 2015, 2014, and 2013.

|                  | Contracts Purchased During the Year Ended (1) |         |                   |         |                   |         |
|------------------|---|---------|-------------------|---------|-------------------|---------|
|                  | December 31, 2015                             |         | December 31, 2014 |         | December 31, 2013 |         |
|                  | (dollars in thousands)                        |         |                   |         |                   |         |
|                  | Amount  | Percent | Amount            | Percent | Amount            | Percent |
|                  | Financed                                      | (1)     | Financed          | (1)     | Financed          | (1)     |
| Preferred        | \$44,881                                      | 4.2%    | \$40,534          | 4.3%    | \$25,135          | 3.3%    |
| Super Alpha      | 119,705                                       | 11.3%   | 127,994           | 13.5%   | 116,551           | 15.3%   |
| Alpha Plus       | 169,470                                       | 16.0%   | 137,337           | 14.5%   | 101,907           | 13.3%   |
| Alpha            | 483,050                                       | 45.5%   | 395,858           | 41.9%   | 320,558           | 42.0%   |
| Standard         | 111,956                                       | 10.6%   | 90,412            | 9.6%    | 78,320            | 10.3%   |
| Mercury / Delta  | 91,101  | 8.6%    | 89,075            | 9.4%    | 66,656            | 8.7%    |
| First Time Buyer | 40,335  | 3.8%    | 63,734            | 6.7%    | 54,960            | 7.2%    |
| Bravo            | 40  | 0.0%    |                   |         |                   |         |
|                  | \$1,060,538                                   | 100.0%  | \$944,944         | 100.0%  | \$764,087         | 100.0%  |

(1) Percentages may not total to 100.0% due to rounding.

We attempt to control misrepresentation regarding the customer's credit worthiness by carefully screening the automobile contracts we purchase, by establishing and maintaining professional business relationships with dealers, and by including certain representations and warranties by the dealer in the dealer agreement. Pursuant to the dealer agreement, we may require the dealer to repurchase any automobile contract in the event that the dealer breaches its representations or warranties. There can be no assurance, however, that any dealer will have the willingness or the financial resources to satisfy its repurchase obligations to us.

In addition to our purchases of installment contracts from dealers, we purchased from 2006 through 2008 an immaterial number of vehicle purchase money loans, evidenced by promissory notes and security agreements. A non-affiliated lender originated all such loans directly to vehicle purchasers, and sold the loans to us. We began financing vehicle purchases by lending money directly to consumers in January 2008, on terms similar to those that we offered through dealers, though without a down payment requirement and with more restrictive loan-to-value and credit score requirements. In October 2008 we suspended purchases of loans from other lenders and direct lending to consumers. In April of 2015, we re-established our platform for direct lending to consumers and originated \$1.5 million of such loans during 2015.

In 2012, we initiated a program to make direct loans secured by automobiles to consumers who own their vehicles. As of December 31, 2015 our managed portfolio includes \$1.6 million of such loans.

## Underwriting

To be eligible for purchase, we require that the automobile contract be originated by a dealer that has entered into a dealer agreement with us. The automobile contract must be secured by a first priority lien on a new or used automobile, light truck or passenger van and must meet our underwriting criteria. In addition, each automobile contract requires the customer to maintain physical damage insurance covering the financed vehicle and naming us as a loss payee. We may, nonetheless, suffer a loss upon theft or physical damage of any financed vehicle if the customer fails to maintain insurance as required by the automobile contract and is unable to pay for repairs to or replacement of the vehicle.

We believe that our underwriting criteria enable us to evaluate effectively the creditworthiness of sub-prime customers and the adequacy of the financed vehicle as security for an automobile contract. The underwriting criteria include standards for price, term, amount of down payment, installment payment and interest rate; mileage, age and type of vehicle; principal amount of the automobile contract in relation to the value of the vehicle; customer income level, employment and residence stability, credit history and debt service ability, as well as other factors. Specifically, our underwriting guidelines generally limit the maximum principal amount of a purchased automobile contract to 115% of wholesale book value in the case of used vehicles or to 115% of the manufacturer's invoice in the case of new vehicles, plus, in each case, sales tax, licensing and, when the customer purchases such additional items, a service contract or a policy to supplement the customer's casualty policy in the event of a total loss of the related vehicle. We generally do not finance vehicles that are more than 11 model years old or have in excess of 150,000 miles. The maximum term of a purchased contract is 72 months, although we consider the loan to value and mileage as significant factors in determining the maximum term of a contract. Automobile contract purchase criteria are subject to change from time to time as circumstances may warrant. Prior to purchasing an automobile contract, our underwriters verify the customer's employment, income, residency, insurance coverage, and credit information by contacting various parties noted on the customer's application, credit information bureaus and other sources. In addition, we contact each customer by telephone to confirm that the customer understands and agrees to the terms of the related automobile contract. During this "welcome call," we also ask the customer a series of open ended questions about his application and the contract, which may uncover potential misrepresentations.

*Credit Scoring.* We use proprietary scoring models to assign each automobile contract several "credit scores" at the time the application is received from the dealer and the customer's credit information is retrieved from the credit reporting agencies. These proprietary scores are used to help determine whether or not we want to approve the application and, if so, the program and pricing we will offer to the dealer. The credit scores are based on a variety of parameters including the customer's credit history, residence stability and total income. Once a vehicle is selected by the customer and a proposed deal structure is provided to us by the dealer, our scores will then consider various deal structure parameters such as down payment amount and the make and mileage of the vehicle. We have developed the credit scores utilizing statistical risk management techniques and historical performance data from our managed portfolio. We believe this improves our allocation of credit evaluation resources, enhances our competitiveness in the marketplace and manages the risk inherent in the sub-prime market.

*Characteristics of Contracts.* All of the automobile contracts we purchase are fully amortizing and provide for level payments over the term of the automobile contract. All automobile contracts may be prepaid at any time without penalty. The average original principal amount financed under the CPS programs in 2015 was \$16,447, with an average original term of 65 months and an average down payment amount of 11.3%. Based on information contained in customer applications for this 12-month period, the retail purchase price of the related automobiles averaged \$16,377 (which excludes tax, license fees and any additional costs such as a service contract) and the average age of the vehicle at the time the automobile contract was purchased was five years. The average age of our customers is approximately 43, with approximately \$54,000 in average annual household income and an average of six years tenure with his or her current employer.

*Dealer Compliance.* The dealer agreement and related assignment contain representations and warranties by the dealer that an application for state registration of each financed vehicle, naming us as secured party with respect to the vehicle, was effected by the time of sale of the related automobile contract to us, and that all necessary steps have been taken to obtain a perfected first priority security interest in each financed vehicle in favor of us under the laws of the state in which the financed vehicle is registered. To the extent that we do not receive such state registration within three months of purchasing the automobile contract, our dealer compliance group will work with the dealer in an attempt to rectify the situation. If these efforts are unsuccessful, we generally will require the dealer to repurchase the automobile contract.

## Servicing and Collection

We currently service all automobile contracts that we own as well as those automobile contracts that are included in portfolios that we have sold in securitizations or service for third parties. We organize our servicing activities based on the tasks performed by our personnel. Our servicing activities consist of mailing monthly billing statements; collecting, accounting for and posting of all payments received; responding to customer inquiries; taking all necessary action to maintain the security interest granted in the financed vehicle or other collateral; investigating delinquencies; communicating with the customer to obtain timely payments; repossessing and liquidating the collateral when necessary; collecting deficiency balances; and generally monitoring each automobile contract and the related collateral. We are typically entitled to receive a base monthly servicing fee equal to 2.5% per annum computed as a



percentage of the declining outstanding principal balance of the non-charged-off automobile contracts in the securitization pools. The servicing fee is included in interest income for those securitization transactions that are treated as financings.

*Collection Procedures.* We believe that our ability to monitor performance and collect payments owed from sub-prime customers is primarily a function of our collection approach and support systems. We believe that if payment problems are identified early and our collection staff works closely with customers to address these problems, it is possible to correct many problems before they deteriorate further. To this end, we utilize pro-active collection procedures, which include making early and frequent contact with delinquent customers; educating customers as to the importance of maintaining good credit; and employing a consultative and customer service approach to assist the customer in meeting his or her obligations, which includes attempting to identify the underlying causes of delinquency and cure them whenever possible. In support of our collection activities, we maintain a computerized collection system specifically designed to service automobile contracts with sub-prime customers and similar consumer obligations.

We attempt to make telephonic contact with delinquent customers from one to 15 days after their monthly payment due date, depending on our proprietary behavioral scorecards which assess the customer's likelihood of payment during early stages of delinquency. Our contact priorities may be based on the customers' physical location, stage of delinquency, size of balance or other parameters. Our collectors inquire of the customer the reason for the delinquency and when we can expect to receive the payment. The collector will attempt to get the customer to make an electronic payment over the phone or a promise for the payment for a time generally not to exceed one week from the date of the call. If the customer makes such a promise, the account is routed to a promise queue and is not contacted until the outcome of the promise is known. If the payment is made by the promise date and the account is no longer delinquent, the account is routed out of the collection system. If the payment is not made, or if the payment is made, but the account remains delinquent, the account is returned to the queue for subsequent contacts.

If a customer fails to make or keep promises for payments, or if the customer is uncooperative or attempts to evade contact or hide the vehicle, a supervisor will review the collection activity relating to the account to determine if repossession of the vehicle is warranted. Generally, such a decision will occur between the 60th and 90th day past the customer's payment due date, but could occur sooner or later, depending on the specific circumstances. At the time the vehicle is repossessed we will stop accruing interest on this automobile contract, and reclassify the remaining automobile contract balance to other assets. In addition we will apply a specific reserve to this automobile contract so that the net balance represents the estimated fair value less costs to sell.

If we elect to repossess the vehicle, we assign the task to an independent local repossession service. Such services are licensed and/or bonded as required by law. When the vehicle is recovered, the repossession service delivers it to a wholesale automobile auction, where it is kept until sold. Financed vehicles that have been repossessed are generally resold through unaffiliated automobile auctions, which are attended principally by car dealers. Net liquidation proceeds are applied to the customer's outstanding obligation under the automobile contract. Such proceeds usually are insufficient to pay the customer's obligation in full, resulting in a deficiency. In most cases we will continue to contact our customers to recover all or a portion of this deficiency for up to several years after charge-off. From time to time, we sell certain charged off accounts to unaffiliated purchasers who specialize in collecting such accounts.

Once an automobile contract becomes greater than 90 days delinquent, we do not recognize additional interest income until the borrower makes sufficient payments to be less than 90 days delinquent. Any payments received by a borrower that are greater than 90 days delinquent are first applied to accrued interest and then to principal reduction.

We generally charge off the balance of any contract by the earlier of the end of the month in which the automobile contract becomes five scheduled installments past due or, in the case of repossessions, the month that after we receive the proceeds from the liquidation of the financed vehicle or if the vehicle has been in repossession inventory for more than three months. In the case of repossession, the amount of the charge-off is the difference between the outstanding principal balance of the defaulted automobile contract and the net repossession sale proceeds.

### Credit Experience

Our primary method of monitoring ongoing credit quality of our portfolio is to closely review monthly delinquency, default and net charge off activity and the related trends. Our internal credit performance data consistently show that new receivables have lower levels of delinquency and losses early in their lives, with delinquencies increasing throughout their lives and losses gradually increasing to a peak between 36 and 42 months, after which they gradually decrease. The weighted average seasoning of our total owned portfolio, represented in the tables below, was 16 months, 14 months and 14 months as of December 31, 2015, December 31, 2014, and December 31, 2013, respectively. 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 became subject to a consent decree that required that we implement procedural changes in our servicing practices, which changes may have contributed to somewhat higher delinquencies, extensions and net losses compared to prior periods. The tables below document the delinquency, repossession and net credit loss experience of all such automobile contracts that we were servicing as of the respective dates shown. The tables do not include the experience of third party servicing portfolios.

**Delinquency, Repossession and Extension Experience**

## Delinquency and Extension Experience (1)

## Total Owned Portfolio

|   | December 31, 2015                                   |             | December 31, 2014         |             | December 31, 2013         |             |
|---|---|-------------|---------------------------|-------------|---------------------------|-------------|
|   | Number<br>of<br>Contracts<br>(Dollars in thousands) | Amount      | Number<br>of<br>Contracts | Amount      | Number<br>of<br>Contracts | Amount      |
| <b>Delinquency Experience</b>   |   |             |                           |             |                           |             |
| Gross servicing portfolio (1)   | 149,138   | \$2,031,099 | 123,944                   | \$1,643,471 | 99,099                    | \$1,228,579 |
| Period of delinquency (2)   |   |             |                           |             |                           |             |
| 31-60 days  | 5,375   | 70,041      | 3,684                     | 43,085      | 3,018                     | 22,765      |
| 61-90 days  | 3,140   | 41,142      | 1,866                     | 23,407      | 2,149                     | 25,167      |
| 91+ days  | 3,364   | 43,484      | 1,935                     | 23,301      | 1,270                     | 11,294      |
| Total delinquencies (2)   | 11,879  | 154,667     | 7,485                     | 89,793      | 6,437                     | 59,226      |
| Amount in repossession (3)  | 3,138   | 38,939      | 2,665                     | 28,250      | 2,991                     | 25,130      |
| Total delinquencies and amount in repossession (2)  | 15,017  | \$193,606   | 10,150                    | \$118,043   | 9,428                     | \$84,356    |
| Delinquencies as a percentage of gross servicing portfolio                                  | 8.0   | % 7.6       | % 6.0                     | % 5.5       | % 6.5                     | % 4.8       |
| Total delinquencies and amount in repossession as a percentage of gross servicing portfolio | 10.1  | % 9.5       | % 8.2                     | % 7.2       | % 9.5                     | % 6.9       |
| <b>Extension Experience</b>   |   |             |                           |             |                           |             |
| Contracts with one extension, accruing (4)  | 26,682  | \$361,338   | 18,377                    | \$238,643   | 14,957                    | \$180,181   |
| Contracts with two or more extensions, accruing (4)   | 16,638  | 219,175     | 7,840                     | 94,035      | 6,134                     | 46,793      |
|   | 43,320  | 580,513     | 26,217                    | 332,678     | 21,091                    | 226,974     |
| Contracts with one extension, non-accrual (4)   | 1,784   | 22,725      | 1,285                     | 14,723      | 1,090                     | 9,503       |
| Contracts with two or more extensions, non-accrual (4)                                      | 1,444   | 18,527      | 612                       | 6,499       | 657                       | 3,385       |
|   | 3,228   | 41,252      | 1,897                     | 21,222      | 1,747                     | 12,888      |
| Total accounts with extensions  | 46,548  | \$621,765   | 28,114                    | \$353,900   | 22,838                    | \$239,862   |

All amounts and percentages are based on the amount remaining to be repaid on each automobile contract. The information in the table represents the gross principal amount of all automobile contracts we purchased, including (1) automobile contracts we 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.

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 (2) 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 the contract balance on financed vehicles that have been repossessed but not yet liquidated.

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

## Net Credit Loss Experience (1)

## Total Owned Portfolio

|  | Year Ended December 31, |   |              |   |              |   |
|--|-------------------------|---|--------------|---|--------------|---|
|  | 2015                    |   | 2014         |   | 2013         |   |
|  | (Dollars in thousands)  |   |              |   |              |   |
| Average servicing portfolio outstanding                            | \$ 1,847,764            |   | \$ 1,421,587 |   | \$ 1,075,979 |   |
| Net charge-offs as a percentage of average servicing portfolio (2) | 6.4                     | % | 5.8          | % | 4.7          | % |

*All amounts and percentages are based on the principal amount scheduled to be paid on each automobile contract (1) contracts. The information in the table represents all automobile contracts we service, excluding certain contracts we have serviced for third-parties on which we earn servicing fees only, and have no credit risk.*

*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 (2) charge-off, including some recoveries which have been classified as other income in the accompanying financial statements.*

*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 an 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) from the obligor, thereby indicating an additional monetary and psychological commitment to the contract on the obligor's part. Fees collected in conjunction with an extension are credited to obligors' outstanding accrued interest.

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 payments; (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 December 31, 2015, for accounts that received extensions from 2008 through 2014:

| Period of Extension | # Extensions Granted | Active or Paid Off at December 31, 2015 | % Active or Paid Off at December 31, 2015 | 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               | 10,728                                  | 30.1 %                                    | 20,038                                 | 56.3 %                                   | 4,819                                  | 13.5 %                                   | 19                                      |
| 2009                | 32,226               | 10,291                                  | 31.9 %                                    | 16,152                                 | 50.1 %                                   | 5,783                                  | 17.9 %                                   | 17                                      |
| 2010                | 26,167               | 12,190                                  | 46.6 %                                    | 11,978                                 | 45.8 %                                   | 1,999                                  | 7.6 %                                    | 19                                      |
| 2011                | 18,786               | 11,042                                  | 58.8 %                                    | 6,812                                  | 36.3 %                                   | 932                                    | 5.0 %                                    | 19                                      |
| 2012                | 18,783               | 11,787                                  | 62.8 %                                    | 6,200                                  | 33.0 %                                   | 796                                    | 4.2 %                                    | 16                                      |
| 2013                | 23,398               | 14,635                                  | 62.5 %                                    | 7,787                                  | 33.3 %                                   | 976                                    | 4.2 %                                    | 15                                      |
| 2014                | 25,773               | 19,195                                  | 74.5 %                                    | 5,752                                  | 22.3 %                                   | 826                                    | 3.2 %                                    | 11                                      |

We view these results as a confirmation of the effectiveness of our extension program. We consider accounts that have had extensions and were active or paid off at December 31, 2015 to be successful. Successful extensions result in continued payments of interest and principal (including payment in full in many cases). Without the extension, however, we would have likely incurred a substantial loss and no additional interest revenue.

For extension accounts that ultimately charged off, we consider accounts that charged off more than six months after the extension to be at least partially successful. In such cases, in spite of the ultimate loss, we received additional payments of principal and interest that otherwise we would not have received.





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

|   | Year<br>Ended<br>December<br>31,<br>2015 | Year<br>Ended<br>December<br>31,<br>2014 | Year<br>Ended<br>December<br>31,<br>2013 |
|---|--|--|--|
| Average number of extensions granted per month          | 4,443                                    | 2,148                                    | 1,950                                    |
| Average number of outstanding accounts                  | 137,306                                  | 110,356                                  | 93,247                                   |
| Average monthly extensions as % of average outstandings | 3.2                                      | % 1.9                                    | % 2.1                                    |

Table excludes extensions on portfolios serviced for third parties

|                                 | December 31, 2015         |             | December 31, 2014         |             | December 31, 2013         |             |
|---------------------------------|---------------------------|-------------|---------------------------|-------------|---------------------------|-------------|
|                                 | Number<br>of<br>Contracts | Amount      | Number<br>of<br>Contracts | Amount      | Number<br>of<br>Contracts | Amount      |
|                                 | (Dollars in thousands)    |             |                           |             |                           |             |
| Contracts with one extension    | 28,466                    | \$384,064   | 19,662                    | \$253,366   | 16,047                    | \$189,684   |
| Contracts with two extensions   | 11,763                    | 156,840     | 6,378                     | 79,774      | 4,397                     | 38,499      |
| Contracts with three extensions | 4,567                     | 59,255      | 1,603                     | 17,452      | 1,486                     | 7,790       |
| Contracts with four extensions  | 1,401                     | 17,734      | 365                       | 2,710       | 634                       | 2,519       |
| Contracts with five extensions  | 301                       | 3,351       | 74                        | 442         | 224                       | 1,059       |
| Contracts with six extensions   | 50                        | 521         | 32                        | 157         | 50                        | 309         |
|                                 | 46,548                    | \$621,765   | 28,114                    | \$353,900   | 22,838                    | \$239,860   |
| Gross servicing portfolio       | 149,138                   | \$2,031,099 | 123,944                   | \$1,643,471 | 99,099                    | \$1,228,579 |

Table excludes extensions on portfolios serviced for 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 is 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 contract becomes greater than 90 days past due, it is more likely than not that the delinquency will not 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 an obligor exceeds the 90 days past due threshold at the end of one period, and then makes the necessary payments such that it becomes equal to or below 90 days delinquent at the end of a subsequent period, the related contract 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).

## Securitization of Automobile Contracts

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 be purchased by institutional investors. 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 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 68 term securitizations of automobile contracts that we purchased from dealers under our regular programs. As of December 31, 2015, 18 of those securitizations are active and all but one are structured as secured financings. The exception is our September 2010 transaction, which 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. In recent years, we have found that the securitizations we conducted in December of those years, had a tendency toward less investor demand in the related bonds than the securitizations we conducted in other times of the year. As a result, in 2015, we elected to defer what would have been our December securitization in favor of a securitization in January 2016.

Our history of term securitizations, over the most recent ten years, is summarized in the table below:

### Recent Asset-Backed Term Securitizations

| Period | Number<br>of Term<br>Securitizations | Amount of<br>Receivables |
|--------|--------------------------------------|--------------------------|
|--------|--------------------------------------|--------------------------|

\$ in thousands

|      |   |           |
|------|---|-----------|
| 2006 | 4 | 957,681   |
| 2007 | 4 | 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   |

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 December 31, 2015 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 securitization trust were not delivered until after the initial closing. As a result, our restricted cash balance at December 31, 2014 included \$85.3 million from the proceeds of the sale of the asset-backed notes that were held by a trustee pending delivery of the remaining receivables. In January 2015, the requisite additional receivables were delivered to the securitization trust and we received the related restricted cash, most of which was used to repay amounts owed under our warehouse credit facilities. Since we did not do a securitization in December of 2015, there was no related amount of restricted cash representing the pre-funding proceeds.

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 2014, extending the revolving period to August 2016, and adding an amortization period through August 2017. 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, which has a revolving period extending to November 2017, followed by an amortization period to November 2019.

In a securitization and in our warehouse credit facilities, we are required to make certain representations and warranties, which are generally similar to the representations and warranties made by dealers in connection with our purchase of the automobile contracts. If we breach any of our representations or warranties, we may be required to repurchase the automobile contract at a price equal to the principal balance plus accrued and unpaid interest. We may then be entitled under the terms of our dealer agreement to require the selling dealer to repurchase the contract at a price equal to our purchase price, less any principal payments made by the customer. Subject to any recourse against dealers, we will bear the risk of loss on repossession and resale of vehicles under automobile contracts that we repurchase.

Whether a securitization is treated as a secured financing or as a sale for financial accounting purposes, the related special purpose subsidiary may be unable to release excess cash to us if the credit performance of the securitized automobile contracts falls short of pre-determined standards. Such releases represent a material portion of the cash that we use to fund our operations. An unexpected deterioration in the performance of securitized automobile contracts could therefore have a material adverse effect on both our liquidity and results of operations, regardless of whether such automobile contracts are treated as having been sold or as having been financed.

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 securitization and non-securitization related debt contain cross-default provisions that would allow certain creditors to declare a default if a default occurred under a different facility. As of December 31, 2015 we were in compliance with all such covenants.

## Competition

The automobile financing business is highly competitive. We compete with a number of national, regional and local finance companies with operations similar to ours. In addition, competitors or potential competitors include other types of financial services companies, such as banks, leasing companies, credit unions providing retail loan financing and lease financing for new and used vehicles, and captive finance companies affiliated with major automobile manufacturers. Many of our competitors and potential competitors possess substantially greater financial, marketing, technical, personnel and other resources than we do. Moreover, our future profitability will be directly related to the availability and cost of our capital in relation to the availability and cost of capital to our competitors. Our competitors and potential competitors include far larger, more established companies that have access to capital markets for unsecured commercial paper and investment grade-rated debt instruments and to other funding sources that may be unavailable to us. Many of these companies also have long-standing relationships with dealers and may provide other financing to dealers, including floor plan financing for the dealers' purchase of automobiles from manufacturers, which we do not offer.

We believe that the principal competitive factors affecting a dealer's decision to offer automobile contracts for sale to a particular financing source are the monthly payment amount made available to the dealer's customer, the purchase price offered for the automobile contracts, the timeliness of the response to the dealer upon submission of the initial application, the amount of required documentation, the consistency and timeliness of purchases and the financial stability of the funding source. While we believe that we can obtain from dealers sufficient automobile contracts for purchase at attractive prices by consistently applying reasonable underwriting criteria and making timely purchases of qualifying automobile contracts, there can be no assurance that we will do so.

## Regulation

Numerous federal and state consumer protection laws, including the federal Truth-In-Lending Act, the federal Equal Credit Opportunity Act, the federal Fair Debt Collection Practices Act and the Federal Trade Commission Act, regulate consumer credit transactions. These laws mandate certain disclosures with respect to finance charges on automobile contracts and impose certain other restrictions. In most states, a license is required to engage in the business of purchasing automobile contracts from dealers. In addition, laws in a number of states impose limitations on the amount of finance charges that may be charged by dealers on credit sales. The so-called Lemon Laws enacted by various states provide certain rights to purchasers with respect to automobiles that fail to satisfy express warranties. The application of Lemon Laws or violation of such other federal and state laws may give rise to a claim or defense of a customer against a dealer and its assignees, including us and those who purchase automobile contracts from us. The dealer agreement contains representations by the dealer that, as of the date of assignment of automobile contracts, no such claims or defenses have been asserted or threatened with respect to the automobile contracts and that all requirements of such federal and state laws have been complied with in all material respects. Although a dealer would be obligated to repurchase automobile contracts that involve a breach of such warranty, there can be no assurance that the dealer will have the financial resources to satisfy its repurchase obligations. Certain of these laws also regulate our servicing activities, including our methods of collection.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) was enacted in July 2010, and many of its provisions became effective in July 2011. The Dodd-Frank Act restructured the regulation and supervision of the financial services industry and created the Consumer Financial Protection Bureau (the “CFPB”). The CFPB has rulemaking, supervisory and enforcement authority over “non-banks,” including us. The CFPB is specifically authorized, among other things, to take actions to prevent companies from engaging in “unfair, deceptive or abusive” acts or practices in connection with consumer financial products and services, and to issue rules requiring enhanced disclosures for consumer financial products or services. Under the Dodd-Frank Act, the CFPB also may restrict the use of pre-dispute mandatory arbitration clauses in contracts for a consumer financial product or service. The CFPB also has authority to interpret, enforce and issue regulations implementing enumerated consumer laws, including certain laws that apply to us. Further, the CFPB has general supervisory and examination authority over non-depository “larger participants” in the market for automotive finance companies. We are subject to such supervision and examination.

The Dodd-Frank Act and related regulations are likely to affect our cost of doing business, may limit or expand our permissible activities, may affect the competitive balance within our industry and market areas and could have a material adverse effect on us. For example, in March 2013, the CFPB stated its view that policies of indirect auto lenders that allow auto dealers to mark up lender-established buy rates and that compensate dealers for those markups could present a risk of impermissible pricing disparities on the basis of race and national origin, and potentially other prohibited bases. We continue to assess the Dodd-Frank Act’s probable effect on our business, financial condition and results of operations, and to monitor developments involving the entities charged with promulgating regulations. However, the ultimate effect of the Dodd-Frank Act on the financial services industry in general, and on us in particular, is uncertain at this time.

In addition to the CFPB, other state and federal agencies have the ability to regulate aspects of our business. For example, the Dodd-Frank Act provides a mechanism for state Attorneys General to investigate us. In addition, the Federal Trade Commission has jurisdiction to investigate aspects of our business. We expect that regulatory investigation by both state and federal agencies will continue, and there can be no assurance that the results of such investigations will not have a material adverse effect on us.

We believe that we are currently in material compliance with applicable statutes and regulations; however, there can be no assurance that we are correct, nor that we will be able to maintain such compliance. The past or future failure to comply with applicable statutes and regulations could have a material adverse effect on us. Furthermore, the adoption of additional statutes and regulations, changes in the interpretation and enforcement of current statutes and regulations or the expansion of our business into jurisdictions that have adopted more stringent regulatory requirements than those in which we currently conduct business could have a material adverse effect on us. In addition, due to the consumer-oriented nature of our industry and the application of certain laws and regulations, industry participants are regularly named as defendants in litigation involving alleged violations of federal and state laws and regulations and consumer law torts, including fraud. Many of these actions involve alleged violations of consumer protection laws. A significant judgment against us or within the industry in connection with any such litigation could have a material adverse effect on our financial condition, results of operations or liquidity.



## Employees

As of December 31, 2015, we had 935 employees. The breakdown of the employees is as follows: 10 were senior management personnel; 487 were servicing personnel; 243 were automobile contract origination personnel; 140 were marketing personnel (109 of whom were marketing representatives); 26 were operations and systems personnel; and 29 were administrative personnel. We believe that our relations with our employees are good. We are not a party to any collective bargaining agreement.

## Item 1A. RISK FACTORS

Our business, operating results and financial condition could be adversely affected by any of the following specific risks. The trading price of our common stock could decline due to any of these risks and other industry risks. This listing of risks by its nature cannot be exhaustive, and the order in which the risks appear is not intended as an indication of their relative weight or importance. In addition to the risks described below, we may encounter risks that we do not currently recognize or that we currently deem immaterial, which may also impair our business operations and the value of our common stock.

## Risks Related to Our Business

### We Require a Substantial Amount of Cash to Service Our Substantial Debt.

To service our existing substantial indebtedness, we require a significant amount of cash. Our ability to generate cash depends on many factors, including our successful financial and operating performance. Our financial and operational performance depends upon a number of factors, many of which are beyond our control. These factors include, without limitation:

- the economic and competitive conditions in the asset-backed securities market;
- the performance of our current and future automobile contracts;
- the performance of our residual interests from our securitizations and warehouse credit facilities;
- any operating difficulties or pricing pressures we may experience;
- our ability to obtain credit enhancement for our securitizations;
- our ability to establish and maintain dealer relationships;
- the passage of laws or regulations that affect us adversely;
- our ability to compete with our competitors; and
- our ability to acquire and finance automobile contracts.

Depending upon the outcome of one or more of these factors, we may not be able to generate sufficient cash flow from operations or obtain sufficient funding to satisfy all of our obligations. Such factors may result in our being unable to pay our debts timely or as agreed. If we were unable to pay our debts, we would be required to pursue one or more alternative strategies, such as selling assets, refinancing or restructuring our indebtedness or selling additional equity capital. These alternative strategies might not be feasible at the time, might prove inadequate, or could require the prior consent of our lenders. If executed, these strategies could reduce the earnings available to our shareholders.

### We Need Substantial Liquidity to Operate Our Business.

We have historically funded our operations principally through internally generated cash flows, sales of debt and equity securities, including through securitizations and warehouse credit facilities, borrowings under senior secured debt agreements and sales of subordinated notes. However, we may not be able to obtain sufficient funding for our future operations from such sources. During 2008, 2009 and much of 2010, our access to the capital markets was impaired with respect to both short-term and long-term funding. While our access to such funding has improved since then, our results of operations, financial condition and cash flows have been and may continue to be materially and adversely affected. We require a substantial amount of cash liquidity to operate our business. Among other things, we use such cash liquidity to:

- acquire automobile contracts;
- fund overcollateralization in warehouse credit facilities and securitizations;
- pay securitization fees and expenses;
- fund spread accounts in connection with securitizations;
- satisfy working capital requirements and pay operating expenses;
- pay taxes; and
- pay interest expense.

Historically we have matched our liquidity needs to our available sources of funding by reducing our acquisition of new automobile contracts, at times to merely nominal levels. There can be no assurance that we will continue to be successful with that strategy.

#### Periods of Significant Losses.

From time to time throughout our history we have incurred net losses, most recently over the period beginning with the quarter ended September 30, 2008 and ending with the quarter ended September 30, 2011. We were adversely affected by the economic recession affecting the United States as a whole, for a time by increased financing costs and decreased availability of capital to fund our purchases of automobile contracts, and by a decrease in the overall level of sales of automobiles and light trucks. Similar periods of losses began in the quarter ended March 31, 1999 through the quarter ended December 31, 2000 and also from the quarter ended September 30, 2003 through the quarter ended March 31, 2005.

We expect to earn quarterly profits during 2016; however, there can be no assurance as to that expectation. Our expectation of profitability is a forward-looking statement. We discuss the assumptions underlying that expectation under the caption “Forward-Looking Statements” in this report. We identify important factors that could cause actual results to differ, generally in the “Risk Factors” section of this report, and also under the caption “Forward-Looking Statements.” One reason for our expectation is that we have had positive net income throughout the four years ended December 31, 2015.

For the year ended December 31, 2015, our pretax income was \$61.4 million, compared to pretax income of \$52.2 million, \$37.2 million and \$9.2 million for the years 2014, 2013 and 2012, respectively, and a pretax loss of \$14.5 million for the year 2011. Our net income for 2015 was \$34.7 million, or \$1.10 per diluted share, compared to net income of \$29.5 million, or \$0.92 per diluted share, \$21.0 million, or \$0.67 per diluted share and \$69.4 million, or \$2.72 per diluted share for the years 2014, 2013 and 2012 respectively, and a net loss of \$14.5 million, or \$0.76 per diluted share, for 2011. Net income for 2012 includes an income tax benefit of \$60.2 million, or \$2.36 per diluted share, related to reversal of a valuation allowance against our deferred tax asset. Such tax benefit cannot be expected to recur.

**Our Results of Operations Will Depend on Our Ability to Secure and Maintain Adequate Credit and Warehouse Financing on Favorable Terms.**

Our business strategy requires that warehouse credit facilities be available in order to purchase significant volumes of receivables.

Historically, our primary sources of day-to-day liquidity have been our warehouse credit facilities, in which we sell and contribute automobile contracts, as often as twice a week, to special-purpose subsidiaries, where they are "warehoused" until they are financed on a long-term basis through the issuance of asset-backed notes. Upon issuance of the notes, funds advanced under one or more warehouse credit facilities are repaid from the proceeds. 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 2014, extending the revolving period to August 2016, and adding an amortization period through August 2017. 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. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Liquidity”.

If we are unable to maintain warehouse financing on acceptable terms, we might curtail or cease our purchases of new automobile contracts, which could lead to a material adverse effect on our results of operations, financial condition and cash flows.

Our Results of Operations Will Depend on Our Ability to Securitize Our Portfolio of Automobile Contracts.

We depend upon our ability to obtain permanent financing for pools of automobile contracts by conducting term securitization transactions. By "permanent financing" we mean financing that extends to cover the full term during which the underlying automobile contracts are outstanding and requires repayment as the underlying automobile contracts are repaid or charged off. By contrast, our warehouse credit facilities permit us to borrow against the value of such receivables only for limited periods of time. Our past practice and future plan has been and is to repay loans made to us under our warehouse credit facilities with the proceeds of securitizations. There can be no assurance that any securitization transaction will be available on terms acceptable to us, or at all. The timing of any securitization transaction is affected by a number of factors beyond our control, any of which could cause substantial delays, including, without limitation:

- market conditions;
- the approval by all parties of the terms of the securitization;
- our ability to acquire a sufficient number of automobile contracts for securitization.

As stated elsewhere in this report, during 2008 and 2009 we observed adverse changes in the market for securitized pools of automobile contracts, which made permanent financing in the form of securitization transactions difficult to obtain and more costly than in prior periods. These changes included reduced liquidity and reduced demand for asset-backed securities, particularly for securities carrying a financial guaranty or for securities backed by sub-prime automobile receivables. Although we have seen improvements in the capital markets from 2010 and thereafter, as compared to 2008 and 2009, if the market conditions for asset-backed securitizations should reverse, we could expect a material adverse effect on our results of operations.

**Our Results of Operations Will Depend on Cash Flows from Our Residual Interests in Our Securitization Program and Our Warehouse Credit Facilities.**

When we finance our automobile contracts through securitizations and warehouse credit facilities, we receive cash and retain a residual interest in the assets financed. Those financed assets are owned by the special-purpose subsidiary that is formed for the related securitization. This residual interest represents the right to receive the future cash flows to be generated by the automobile contracts in excess of (i) the interest and principal paid to investors or lenders on the indebtedness issued in connection with the financing, (ii) the costs of servicing the automobile contracts and (iii) certain other costs incurred in connection with completing and maintaining the securitization or warehouse credit facility. We sometimes refer to these future cash flows as "excess spread cash flows."

Under the financial structures we have used to date in our securitizations and warehouse credit facilities, excess spread cash flows that would otherwise be paid to the holder of the residual interest are first used to increase overcollateralization or are retained in a spread account within the securitization trusts or the warehouse facility to provide liquidity and credit enhancement for the related securities.

While the specific terms and mechanics vary among transactions, our securitization and warehousing agreements generally provide that we will receive excess spread cash flows only if the amount of overcollateralization and spread account balances have reached specified levels and/or the delinquency, defaults or net losses related to the automobile contracts in the automobile contract pools are below certain predetermined levels. In the event delinquencies, defaults or net losses on automobile contracts exceed these levels, the terms of the securitization or warehouse credit facility:

- may require increased credit enhancement, including an increase in the amount required to be on deposit in the spread account to be accumulated for the particular pool; and

- in certain circumstances, may permit affected parties to require the transfer of servicing on some or all of the securitized or warehoused contracts from us to an unaffiliated servicer.

We typically retain residual interests or use them as collateral to borrow cash. In any case, the future excess spread cash flow received in respect of the residual interests is integral to the financing of our operations. The amount of cash received from residual interests depends in large part on how well our portfolio of securitized and warehoused automobile contracts performs. If our portfolio of securitized and warehoused automobile contracts has higher delinquency and loss ratios than expected, then the amount of money realized from our retained residual interests, or the amount of money we could obtain from the sale or other financing of our residual interests, would be reduced. Such higher than expected losses occurred in 2008 through 2010, which had an adverse effect on our operations, financial condition and cash flows. Should significant increases in losses reoccur, such recurrence might have material adverse effects on our future results of operations, financial condition and cash flows.

If We Are Unable to Obtain Credit Enhancement for Our Securitizations Upon Favorable Terms, Our Results of Operations Would Be Impaired.

In our securitizations from 1994 through 2008, we utilized credit enhancement in the form of one or more financial guaranty insurance policies issued by financial guaranty insurance companies. Each of these policies unconditionally and irrevocably guaranteed timely interest and ultimate principal payments on the senior classes of the securities issued in those securitizations. These guarantees enabled those securities to achieve the highest credit rating available. This form of credit enhancement reduced the costs of our securitizations relative to alternative forms of credit enhancement available to us at the time. Due to significantly reduced investor demand for securities carrying such a financial guaranty, this form of credit enhancement may not be economical for us in the future. The 19 securitization transactions we executed from 2010 through 2015 did not utilize financial guaranty insurance policies. Prior to the second quarter of 2014, none of the securities issued in those transactions received the highest possible credit rating from any rating agency. As we pursue future securitizations, we may not be able to obtain:

- credit enhancement in any form on terms acceptable to us, or at all; or
- similar highest available credit ratings for senior classes of securities to be issued in future securitizations.

We have observed an adverse trend in the greater credit spread between the interest rate payable on our securitization trust debt and risk-free investments. As of the date of this report, interest rates on risk-free debt are close to historical lows, which have offset some of the adverse effect on us of greater credit spreads. If interest rates on risk-free debt increase, or if the trend of increased spreads should continue, we would expect increased interest expense, which could adversely affect our results of operations.

**If We Are Unable to Compete Successfully with our Competitors, Our Results of Operations May Be Impaired.**

The automobile financing business is highly competitive. We compete with a number of national, regional and local finance companies. In addition, competitors or potential competitors include other types of financial services companies, such as commercial banks, savings and loan associations, leasing companies, credit unions providing retail loan financing and lease financing for new and used vehicles and captive finance companies affiliated with major automobile manufacturers, such as Ford Motor Credit Corporation. Many of our competitors and potential competitors possess substantially greater financial, marketing, technical, personnel and other resources than we do, including greater access to capital markets for unsecured commercial paper and investment grade rated debt instruments, and to other funding sources which may be unavailable to us. Moreover, our future profitability will be directly related to the availability and cost of our capital relative to that of our competitors. Many of these companies also have long-standing relationships with automobile dealers and may provide other financing to dealers, including floor plan financing for the dealers' purchases of automobiles from manufacturers, which we do not offer. There can be no assurance that we will be able to continue to compete successfully and, as a result, we may not be able to purchase automobile contracts from dealers at a price acceptable to us, which could result in reductions in our revenues or the cash flows available to us.

**If Our Dealers Do Not Submit a Sufficient Number of Suitable Automobile Contracts to Us for Purchase, Our Results of Operations May Be Impaired.**

We are dependent upon establishing and maintaining relationships with a large number of unaffiliated automobile dealers to supply us with automobile contracts. During the years ended December 31, 2015 and 2014, no single dealer accounted for more than 0.75% and 0.40%, respectively, of the automobile contracts we purchased. The agreements we have with dealers to purchase automobile contracts do not require dealers to submit a minimum number of automobile contracts for purchase. The failure of dealers to submit automobile contracts that meet our underwriting criteria could result in reductions in our revenues or the cash flows available to us, and, therefore, could have an adverse effect on our results of operations.

**If a Significant Number of Our Automobile Contracts Experience Defaults, Our Results of Operations May Be Impaired.**



We specialize in the purchase and servicing of automobile contracts to finance automobile purchases by sub-prime customers, those who have limited credit history, low income, or past credit problems. Such automobile contracts entail a higher risk of non-performance, higher delinquencies and higher losses than automobile contracts with more creditworthy customers. While we believe that our pricing of the automobile contracts and the underwriting criteria and collection methods we employ enable us to control, to a degree, the higher risks inherent in automobile contracts with sub-prime customers, no assurance can be given that such pricing, criteria and methods will afford adequate protection against such risks.

If automobile contracts that we purchase and hold experience defaults to a greater extent than we have anticipated, this could materially and adversely affect our results of operations, financial condition, cash flows and liquidity. Our results of operations, financial condition, cash flows and liquidity, depend, to a material extent, on the performance of automobile contracts that we purchase, warehouse and securitize. A portion of the automobile contracts that we acquire will default or prepay. In the event of payment default, the collateral value of the vehicle securing an automobile contract realized by us in a repossession will generally not cover the outstanding principal balance on that automobile contract and the related costs of recovery. We maintain an allowance for credit losses on automobile contracts held on our balance sheet, which reflects our estimates of probable credit losses that can be reasonably estimated for securitizations that are accounted for as financings and warehoused automobile contracts. If the allowance is inadequate, then we would recognize the losses in excess of the allowance as an expense and our results of operations could be adversely affected. In addition, under the terms of our warehouse credit facilities, we are not able to borrow against defaulted automobile contracts, including automobile contracts that are, at the time of default, funded under our warehouse credit facilities, which will reduce the overcollateralization of those warehouse credit facilities and possibly reduce the amount of cash flows available to us.

### If We Lose Servicing Rights on Our Portfolio of Automobile Contracts, Our Results of Operations Would Be Impaired.

We are entitled to receive servicing fees only while we act as servicer under the applicable sale and servicing agreements governing our warehouse credit facilities and securitizations. Under such agreements, we may be terminated as servicer upon the occurrence of certain events, including:

- our failure generally to observe and perform our responsibilities and other covenants;
- certain bankruptcy events; or
- the occurrence of certain events of default under the documents governing the facilities.

The loss of our servicing rights could materially and adversely affect our results of operations, financial condition and cash flows. Our results of operations, financial condition and cash flow, would be materially and adversely affected if we were to be terminated as servicer with respect to a material portion of our managed portfolio.

### If We Lose Key Personnel, Our Results of Operations May Be Impaired.

Our senior management team averages over 19 years of service with us. Charles E. Bradley, Jr., our President and CEO, has been our President since our formation in 1991. Our future operating results depend in significant part upon the continued service of our key senior management personnel, none of whom is bound by an employment agreement. Our future operating results also depend in part upon our ability to attract and retain qualified management, technical, sales and support personnel for our operations. Competition for such personnel is intense. We cannot assure you that we will be successful in attracting or retaining such personnel. Conversely, adverse general economic conditions may have had a countervailing effect. The loss of any key employee, the failure of any key employee to perform in his or her current position or our inability to attract and retain skilled employees, as needed, could materially and adversely affect our results of operations, financial condition and cash flow.

### If We Fail to Comply with Regulations, Our Results of Operations May Be Impaired.

Failure to materially comply with all laws and regulations applicable to us could materially and adversely affect our ability to operate our business. Our business is subject to numerous federal and state consumer protection laws and regulations, which, among other things:

- require us to obtain and maintain certain licenses and qualifications;
- limit the interest rates, fees and other charges we are allowed to charge;
- limit or prescribe certain other terms of our automobile contracts;
- require specific disclosures to our customers;
- define our rights to repossess and sell collateral; and
- maintain safeguards designed to protect the security and confidentiality of customer information.

Our industry is also at times investigated by regulators and offices of state attorneys general, which could lead to enforcement actions, fines and penalties, or the assertion of private claims and law suits against us. The Federal Trade Commission (“FTC”) has the authority to investigate consumer complaints against us, to conduct inquiries at its own instance, and to recommend enforcement actions and seek monetary penalties. The FTC has conducted an inquiry into our practices, and proposed remedial action against us in 2014, to which we consented. See Legal Proceedings – FTC Action. The CFPB has adopted regulations that place us and other companies similar to us under its supervision. Our industry is also under investigation by the United States Department of Justice, which is conducting an inquiry that appears to be focused on securitization practices. In that inquiry, we received a subpoena in January 2015, which required that we produce specified documents. We are cooperating with that inquiry. Such inquiry 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 inquiry or any resulting proceeding(s), which might materially and adversely affect us.

If we fail to comply with applicable laws and regulations, such failure could result in penalties, litigation losses and expenses, damage to our reputation, or the suspension or termination of our licenses to conduct business, which would materially adversely affect our results of operations, financial condition and stock price. In addition, new federal and state laws or regulations or changes in the ways that existing rules or laws are interpreted or enforced could limit our activities in the future or significantly increase the cost of compliance. Furthermore, judges or regulatory bodies could interpret current rules or laws differently than the way we do, leading to such adverse consequences as described above. The resolution of such matters may require considerable time and expense, and if not resolved in our favor, may result in fines or damages, and possibly an adverse effect on our financial condition.

We believe that we are in compliance in all material respects with all such laws and regulations, and that such laws and regulations have had no material adverse effect on our ability to operate our business. However, we may be materially and adversely affected if we fail to comply with:

- applicable laws and regulations;
- changes in existing laws or regulations;
- changes in the interpretation of existing laws or regulations; or
- any additional laws or regulations that may be enacted in the future.

#### Recent Legislation and Proposed Regulations May Have an Adverse Effect on Our Business.

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), adopted in 2010, mandates the most wide-ranging overhaul of financial industry regulation in decades. The law provides a regulatory framework and requires that regulators, some of which are new regulatory bodies created by Dodd-Frank, draft, review and approve more than 200 implementing regulations and conduct numerous studies that are likely to lead to still more regulations.

The Dodd-Frank Act includes risk retention requirements. Six federal agencies have approved a rule implementing these requirements. The rule, which is set to become effective in December 2015, generally requires sponsors of asset-backed securities (ABS), such as us, to retain not less than five percent of the credit risk of the assets collateralizing the ABS issuance. The rule also sets forth prohibitions on transferring or hedging the credit risk that the sponsor is required to retain. Our future securitization structures may be adversely affected by the risk retention requirement.

Compliance with these new laws and regulations may be or likely will be costly and can affect operating results. Compliance requires forms, processes, procedures, controls and the infrastructure to support these requirements. Compliance may create operational constraints and place limits on pricing. Laws in the financial services industry are designed primarily for the protection of consumers. The failure to comply could result in significant statutory civil and criminal penalties, monetary damages, attorneys' fees and costs, possible revocation of licenses and damage to reputation, brand and valued customer relationships.

At this time, it is difficult to predict the extent to which new regulations or amendments will affect our business. However, compliance with these new laws and regulations may result in additional cost and expenses, which may adversely affect our results of operations, financial condition or liquidity.

#### If We Experience Unfavorable Litigation Results, Our Results of Operations May Be Impaired.

We operate in a litigious society and currently are, and may in the future be, named as defendants in litigation, including individual and class action lawsuits under consumer credit, consumer protection, theft, privacy, data security, automated dialing equipment, debt collections and other laws. Many of these cases present novel issues on which there is no clear legal precedent, which increases the difficulty in predicting both the potential outcomes and costs of defending these cases. We are subject to regulatory examinations, investigations, inquiries, litigation, and other actions by licensing authorities, state attorneys general, the Federal Trade Commission, the Consumer Financial Protection Bureau and other governmental bodies relating to our activities. The litigation and regulatory actions to which we are or may become subject involve or may involve potential compensatory or punitive damage claims, fines, sanctions or injunctive relief that, if granted, could require us to pay damages or make other expenditures in amounts that could have a material adverse effect on our financial position and our results of operations. We have recorded loss contingencies in our financial statements only for matters on which losses are probable and can be reasonably estimated. Our assessments of these matters involve significant judgments, and may change from time to time. Actual losses incurred by us in connection with judgments or settlements of these matters may be more than our associated reserves. Furthermore, defending lawsuits and responding to governmental inquiries or investigations, regardless of their merit, could be costly and divert management's attention from the operation of our business. Unfavorable outcomes in any such current or future proceedings could materially and adversely affect our results of operations, financial conditions and cash flows. As a consumer finance company, we are subject to various consumer claims and litigation seeking damages and statutory penalties based upon, among other things, disclosure inaccuracies and wrongful repossession, which could take the form of a plaintiff's class action complaint. We, as the assignee of finance contracts originated by dealers, may also be named as a co-defendant in lawsuits filed by consumers principally against dealers. We are also subject to other litigation common to the automobile industry and to businesses in general. The damages and penalties claimed by consumers and others in these types of matters can be substantial. The relief requested by the plaintiffs varies but includes requests for compensatory, statutory and punitive damages.

While we intend to vigorously defend ourselves against such proceedings, there is a chance that our results of operations, financial condition and cash flows could be materially and adversely affected by unfavorable outcomes.

Negative publicity associated with litigation, governmental investigations, regulatory actions, and other public statements could damage our reputation.

From time to time there are negative news stories about the “sub-prime” credit industry. Such stories may follow the announcements of litigation or regulatory actions involving us or others in our industry. Negative publicity about our alleged or actual practices or about our industry generally could adversely affect our stock price and our ability to retain and attract employees.

**If We Experience Problems with Our Originations, Accounting or Collection Systems, Our Results of Operations May Be Impaired.**

We are dependent on our receivables originations, accounting and collection systems to service our portfolio of automobile contracts. Such systems are vulnerable to damage or interruption from natural disasters, power loss, telecommunication failures, terrorist attacks, computer viruses and other events. A significant number of our systems are not redundant, and our disaster recovery planning is not sufficient for every eventuality. Our systems are also subject to break-ins, sabotage and intentional acts of vandalism by internal employees and contractors as well as third parties. Despite any precautions we may take, such problems could result in interruptions in our services, which could harm our reputation and financial condition. We do not carry business interruption insurance sufficient to compensate us for losses that may result from interruptions in our service as a result of system failures. Such systems problems could materially and adversely affect our results of operations, financial conditions and cash flows.

A breach in the security of our systems could result in the disclosure of confidential information or subject us to liability

We hold in our systems confidential financial and other personal data with respect to our customers, which may be of value to identity thieves and others if revealed. Although we endeavor to protect the security of our computer systems and the confidentiality of customer information entrusted to us, there can be no assurance that our security measures will provide adequate security.

It is possible that we may not be able to anticipate, detect or recognize threats to our systems or to implement effective preventive measures against all security breaches, especially because the techniques used change frequently or are not

recognized until launched, and because cyberattacks can originate from a wide variety of sources, including third parties outside the Company such as persons who are associated with external service providers or who are or may be involved in organized crime or linked to terrorist organizations.

Such persons may also attempt to fraudulently induce employees or other users of our systems to disclose sensitive information in order to gain access to our data or that of our customers.

These risks may increase in the future as we continue to increase our mobile-payment and other internet-based product offerings and expands our use of web-based products and applications.

A successful penetration of the security of our systems could cause serious negative consequences, including disruption of our operations, misappropriation of confidential information, or damage to our computers or systems, and could result in violations of applicable privacy and other laws, financial loss to us or to our customers, customer dissatisfaction, significant litigation exposure and harm to our reputation, any or all of which could have a material adverse effect on us.

**We Have Substantial Indebtedness.**

We currently have and will continue to have a substantial amount of indebtedness. At December 31, 2015, we had approximately \$1,952.2 million of debt outstanding. Such debt consisted primarily of \$1,731.6 million of securitization trust debt, \$196.5 million of warehouse lines of credit, \$9.0 million of residual interest financing and \$15.1 million in subordinated renewable notes. We are also currently offering the subordinated renewable notes to the public on a continuous basis, and such notes have maturities that range from three 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 flows 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 would give rise to various remedies in favor of any unpaid creditors, and creditors' exercise of such remedies could have a material adverse effect on our earnings.

Because We Are Subject to Many Restrictions in Our Existing Credit Facilities and Securitization Transactions, Our Ability to Pay Dividends or Engage in Specified Transactions May Be Impaired.

The terms of our existing credit facilities, term securitizations and our other outstanding debt impose significant operating and financial restrictions on us and our subsidiaries and require us to meet certain financial tests. These restrictions may have an adverse effect on our business activities, results of operations and financial condition. These restrictions may also significantly limit or prohibit us from engaging in certain transactions, including the following:

- incurring or guaranteeing additional indebtedness;
- making capital expenditures in excess of agreed upon amounts;
- paying dividends or other distributions to our shareholders or redeeming, repurchasing or retiring our capital stock or subordinated obligations;
- making investments;
- creating or permitting liens on our assets or the assets of our subsidiaries;
- issuing or selling capital stock of our subsidiaries;
- transferring or selling our assets;
- engaging in mergers or consolidations;
- permitting a change of control of our company;
- liquidating, winding up or dissolving our company;
- changing our name or the nature of our business, or the names or nature of the business of our subsidiaries; and
- engaging in transactions with our affiliates outside the normal course of business.

These restrictions may limit our ability to obtain additional sources of capital, which may limit our ability to generate earnings. In addition, the failure to comply with any of the covenants of one or more of our debt agreements could



cause a default under other debt agreements that may be outstanding from time to time. A default, if not waived, could result in acceleration of the related indebtedness, in which case such debt would become immediately due and payable. A continuing default or acceleration of one or more of our credit facilities or any other debt agreement, would likely cause a default under other debt agreements that otherwise would not be in default, in which case all such related indebtedness could be accelerated. If this occurs, we may not be able to repay our debt or borrow sufficient funds to refinance our indebtedness. Even if any new financing is available, it may not be on terms that are acceptable to us or it may not be sufficient to refinance all of our indebtedness as it becomes due.

In addition, the transaction documents for our securitizations restrict our securitization subsidiaries from declaring or making payment to us of (i) any dividend or other distribution on or in respect of any shares of their capital stock, or (ii) any payment on account of the purchase, redemption, retirement or acquisition of any option, warrant or other right to acquire shares of their capital stock unless (in each case) at the time of such declaration or payment (and after giving effect thereto) no amount payable under any transaction document with respect to the related securitization is then due and owing, but unpaid. These restrictions may limit our ability to receive distributions in respect of the residual interests from our securitization facilities, which may limit our ability to generate earnings.

## Risks Related to General Factors

### If The Economy of All or Certain Regions of the United States Falls into Recession, Our Results of Operations May Be Impaired.

Our business is directly related to sales of new and used automobiles, which are sensitive to employment rates, prevailing interest rates and other domestic economic conditions. Delinquencies, repossessions and losses generally increase during economic slowdowns or recessions. Because of our focus on sub-prime customers, the actual rates of delinquencies, repossessions and losses on our automobile contracts could be higher under adverse economic conditions than those experienced in the automobile finance industry in general, particularly in the states of California, Texas, Ohio, Georgia, Florida and Pennsylvania, states in which our automobile contracts are geographically concentrated. Any sustained period of economic slowdown or recession could adversely affect our ability to acquire suitable automobile contracts, or to securitize pools of such automobile contracts. The timing of any economic changes is uncertain, and weakness in the economy could have an adverse effect on our business and that of the dealers from which we purchase automobile contracts and result in reductions in our revenues or the cash flows available to us.

### Our Results of Operations May Be Impaired as a Result of Natural Disasters.

Our automobile contracts are geographically concentrated in the states of California and Texas. Such states may be particularly susceptible to natural disasters: earthquake in the case of California, and hurricanes and flooding in Texas. Natural disasters, in those states or others, could cause a material number of our vehicle purchasers to lose their jobs, or could damage or destroy vehicles that secure our automobile contracts. In either case, such events could result in our receiving reduced collections on our automobile contracts, and could thus result in reductions in our revenues or the cash flows available to us.

### If an Increase in Interest Rates Results in a Decrease in Our Cash Flows from Excess Spread, Our Results of Operations May Be Impaired.

Our profitability is largely determined by the difference, or "spread," between the effective interest rate we receive on the automobile contracts that we acquire and the interest rates payable under warehouse credit facilities and on the asset-backed securities issued in our securitizations. In the past, disruptions in the market for asset-backed securities resulted in an increase in the interest rates we paid on asset-backed securities. Should similar disruptions take place in the future, we may pay higher interest rates on asset-backed securities issued in the future. Although we have the ability to partially offset increases in our cost of funds by increasing fees we charge to dealers when purchasing automobile contracts, or by demanding higher interest rates on automobile contracts we purchase, there is no

assurance that such actions will materially offset increases in interest we pay to finance our managed portfolio. As a result, an increase in prevailing interest rates could cause us to receive less excess spread cash flows on automobile contracts, and thus could adversely affect our earnings and cash flows. See “Quantitative and Qualitative Disclosures About Market Risk - Interest Rate Risk.”

#### Risks Related to Our Common Stock

##### Our Common Stock Is Thinly-Traded.

Our stock is thinly-traded, which means investors will have limited opportunities to sell their shares of common stock in the open market. Limited trading of our common stock also contributes to more volatile price fluctuations. Because there historically has been low trading volume in our common stock, there can be no assurance that our stock price will not decline as additional shares are sold in the public market. As of December 31, 2015, our directors and executive officers collectively owned 4,405,328 shares of our common stock, or approximately 17%.

##### We Do Not Intend to Pay Dividends on Our Common Stock.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings and do not expect to pay any dividends in the foreseeable future. See "Dividend Policy".

## 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;
- changes in performance of our automobile contracts;
- increases in interest rates;
- our ability to generate sufficient operating and financing cash flows;
- competition;
- level of losses incurred on contracts in our managed portfolio; and
- adverse decisions by courts or regulators

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. See "Where You Can Find More Information" and "Documents Incorporated by Reference."

## Item 1B. Unresolved Staff Comments

Not applicable.

## Item 2. Properties

Our principal executive offices are located in Las Vegas, Nevada. Our operating headquarters are located in Irvine, California, where we currently lease approximately 80,000 square feet of general office space from an unaffiliated lessor. The leased office space in Irvine, California increases to 129,000 square feet by 2017. The annual base rent is approximately \$1.77 million, increasing to approximately \$4.50 million through 2022.

In March 1997, we established a branch collection facility in Chesapeake, Virginia. We lease approximately 16,500 square feet of general office space in Chesapeake, Virginia, at a base rent that is approximately \$280,000 per year, increasing to approximately \$325,000 through 2018.

The remaining three regional servicing centers occupy a total of approximately 68,000 square feet of leased space in Las Vegas, Nevada; Maitland, Florida; and Lombard, Illinois. The termination dates of such leases range from 2018 to 2019. The annual base rent for these facilities total approximately \$1.43 million increasing to approximately \$1.64 million through 2019.

## Item 3. 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 has appealed that approval.)

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 December 31, 2015 with respect to such matters, in the aggregate.

*FTC Action.* In May 2014, we consented to the FTC's filing of a lawsuit against us, and to the simultaneous settlement of that lawsuit pursuant to a consent decree. The agreed judgment, entered June 11, 2014, required that we make restitutionary payments to certain of our customers, that we pay a \$2 million penalty to the U.S. government, and that we implement procedural changes relating to compliance with fair debt collection practices and credit reporting. We have retained an independent third party to monitor our compliance with the judgment, and we must file certain periodic reports with the FTC. The payments to past and present customers have been completed and paid, partially in cash and partially in the form of credits against amounts owed. The total of such customer payments, cash and credit, was approximately \$3.5 million.

*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 requested 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 the required documents in March 2015, and are unaware of any subsequent material developments in the government's investigation. 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 December 31, 2015, 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 December 31, 2015, and in excess of the liability we have recorded, is from \$0 to \$250,000.

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.

Executive Officers of the Registrant

*Charles E. Bradley, Jr.*, 56, has been our President and a director since our formation in March 1991, and was elected Chairman of the Board of Directors in July 2001. In January 1992, Mr. Bradley was appointed Chief Executive Officer. From April 1989 to November 1990, he served as Chief Operating Officer of Barnard and Company, a private investment firm. From September 1987 to March 1989, Mr. Bradley, Jr. was an associate of The Harding Group, a private investment banking firm. Mr. Bradley does not currently serve on the board of directors of any other publicly-traded companies.

*Jeffrey P. Fritz*, 56, has been Executive Vice President and Chief Financial Officer since March 2014. Prior to that, he was Senior Vice President and Chief Financial Officer since April 2006. He was Senior Vice President of Accounting from August 2004 through March 2006 and served as a consultant to us from May 2004 to August 2004. He also served as our Chief Financial Officer from our inception through May 1999. He is a licensed Certified Public Accountant and has previously practiced public accounting.

*Michael T. Lavin*, 43, has been Executive Vice President - Chief Legal Officer since March 2014. Prior to that, he was our Senior Vice President – General Counsel since March 2013, Senior Vice President and Corporate Counsel since May 2009 and our Vice President- Legal since joining the Company in November of 2001. Mr. Lavin was previously engaged as a law clerk and an associate with the San Diego based large law firm (now defunct) of Edwards, Sooy & Byron from 1996 through 2000 and then as an associate with the Orange County based firm of Trachtman & Trachtman from 2000 through 2001. Mr. Lavin also clerked for the San Diego District Attorney's office and Orange County Public Defender's office.

*Mark A. Creatura*, 56, has been Senior Vice President – General Counsel since October 1996. From October 1993 through October 1996, he was Vice President and General Counsel at Urethane Technologies, Inc., a polyurethane chemicals formulator. Mr. Creatura was previously engaged in the private practice of law with the Los Angeles law firm of Troy & Gould Professional Corporation, from October 1985 through October 1993.

*Christopher Terry*, 48, has been Senior Vice President – Asset Recovery since August 2013. Prior to that was our Senior Vice President of Servicing since May 2005, and prior to that was Senior Vice President - Asset Recovery since January 2003. He joined us in January 1995 as a loan officer, held a series of successively more responsible positions, and was promoted to Vice President - Asset Recovery in June 1999. Mr. Terry was previously a branch manager with Norwest Financial from 1990 to October 1994.

*Teri L. Robinson*, 53, has been Senior Vice President of Originations since April 2007. Prior to that, she held the position of Vice President of Originations since August 1998. She joined the Company in June 1991 as an Operations Specialist, and held a series of successively more responsible positions. Previously, Ms. Robinson held an administrative position at Greco & Associates.

*Curtis K. Powell*, 58, has been Senior Vice President – Project Development since May 2010. Previously he was our Senior Vice President – Marketing from March 2007 to May 2010. Prior to that, he was our Senior Vice President of Originations from June 2001 to March 2007. Prior to that, he was our Senior Vice President – Marketing, from April 1995 to June 2001. He joined us in January 1993 as an independent marketing representative until being appointed Regional Vice President of Marketing for Southern California in November 1994. From June 1985 through January 1993, Mr. Powell was in the retail automobile sales and leasing business.

*Laurie A. Straten*, 47, has been Senior Vice President of Servicing since August 2013. Prior to that, she was our Senior Vice President of Asset Recovery since April 2013, and before that she held the position of Vice President of Asset Recovery starting in April 2005. She started with the Company in March 1996 as a bankruptcy specialist and took on more responsibility within Asset Recovery over time. Prior to joining CPS she worked for the FDIC and served in the United States Marine Corps.

*Richard B. Haskell*, 49, has been Senior Vice President of Systems and Risk Management since April 2013. Prior to that, he held the positions of Vice President of Systems and Risk Management since January 2007, and Vice President of Risk Management since January 2005. He joined the Company in March 1994 as a data entry clerk in the Originations Department and held a series of successively more responsible positions. Previously, Mr. Haskell held a position as loan officer at Trust One Mortgage.

*John P. Harton*, 51, has been Senior Vice President - Marketing since March 2014. Prior to that, he held the position of Vice President – Marketing since April 2010. He joined the Company in April 1996 as a loan officer, held a series of successively more responsible positions, and was promoted to Vice President - Originations in June 2007. Mr. Harton was previously a branch manager with American General Finance from 1990 to March 1996.





## PART II

## Item 5. Market for Registrant's Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

The Company's Common Stock is traded on the Nasdaq Global Market, under the symbol "CPSS." The following table sets forth the high and low sale prices as reported by Nasdaq for our Common Stock for the periods shown.

|                               | <b>High</b> | Low  |
|-------------------------------|-------------|------|
| January 1 - March 31, 2014    | 9.64        | 6.63 |
| April 1 - June 30, 2014       | 7.99        | 6.33 |
| July 1 - September 30, 2014   | 8.22        | 6.41 |
| October 1 - December 31, 2014 | 8.00        | 6.36 |
| January 1 - March 31, 2015    | 7.60        | 5.29 |
| April 1 - June 30, 2015       | 7.38        | 5.75 |
| July 1 - September 30, 2015   | 6.55        | 4.87 |
| October 1 - December 31, 2015 | 5.81        | 4.49 |

As of January 1, 2016, there were 37 holders of record of the Company's Common Stock. To date, we have not declared or paid any dividends on our Common Stock. The payment of future dividends, if any, on our Common Stock is within the discretion of the Board of Directors and will depend upon our income, capital requirements and financial condition, and other relevant factors. The instruments governing our outstanding debt place certain restrictions on the payment of dividends. We do not intend to declare any dividends on our Common Stock in the foreseeable future, but instead intend to retain any cash flow for use in our operations.

The table below presents information regarding outstanding options to purchase our Common Stock as of December 31, 2015:

| Plan category | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans |
|---------------|---|---|--|
|               |   |   |  |

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|  |            |         |           |
|--|------------|---------|-----------|
| Equity compensation plans approved by security holders     | 11,227,624 | \$ 4.66 | 5,476,181 |
| Equity compensation plans not approved by security holders | –          | –       | –         |
| Total  | 11,227,624 | \$ 4.66 | 5,476,181 |

27

**Issuer Purchases of Equity Securities in the Fourth Quarter**

| Period(1)     | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price<br>Paid per<br>Share | Total<br>Number of<br>Shares<br>Purchased as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs(2) | Approximate<br>Dollar Value<br>of Shares<br>that May<br>Yet be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|---------------|---|---------------------------------------|---|--|
| October 2015  | 220,544                                   | \$ 5.25                               | 220,544   | \$ 6,981,718   |
| November 2015 | 198,160                                   | 5.21                                  | 198,160   | 5,950,238  |
| December 2015 | 176,217                                   | 5.05                                  | 176,217   | 5,060,683  |
| Total         | 594,921                                   | \$ 5.18                               | 594,921   |  |

(1) *Each monthly period is the calendar month.*

*Through December 31, 2015, our board of directors had authorized the purchase of up to \$44.5 million of our outstanding securities, which program was first announced in our annual report for the year 2002, filed on (2) March 26, 2003. All purchases described in the table above were under the plan announced in March 2003, which has no fixed expiration date. As of December 31, 2015, we have purchased \$5.0 million in principal amount of debt securities and \$34.4 million of our common stock representing 10,864,589 shares.*

**Item 6. Selected Financial Data**

The following table presents our selected consolidated financial data and operating data as of and for the dates indicated. The data under the captions "Statement of Income Data" and "Balance Sheet Data" have been derived from our audited consolidated financial statements. The remainder is derived from other records of ours. You should read the selected consolidated financial data together with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited and unaudited consolidated financial statements and notes thereto that are included in this report, and in our quarterly and periodic filings.

| (in thousands, except per share data)              | As of and<br>For the Year Ended December 31, |             |             |             |            |
|--|--|-------------|-------------|-------------|------------|
|  | 2015   | 2014        | 2013        | 2012        | 2011       |
| <b>Statement of Income Data</b>                    |  |             |             |             |            |
| Revenues:  |  |             |             |             |            |
| Interest income                                    | \$349,912                                    | \$286,734   | \$231,330   | \$175,314   | \$127,856  |
| Servicing fees                                     | 319  | 1,376       | 3,093       | 2,305       | 4,348      |
| Other income                                       | 13,419                                       | 12,146      | 10,405      | 9,589       | 10,927     |
| Gain on cancellation of debt                       | –  | –           | 10,947      | –           | –          |
| Total revenues                                     | 363,650                                      | 300,256     | 255,775     | 187,208     | 143,131    |
| Expenses:  |  |             |             |             |            |
| Employee costs                                     | 59,556                                       | 50,129      | 42,960      | 35,573      | 32,270     |
| General and administrative                         | 42,349                                       | 39,262      | 32,753      | 29,531      | 26,759     |
| Interest expense                                   | 57,745                                       | 50,395      | 58,179      | 79,422      | 83,054     |
| Provision for credit losses                        | 142,618                                      | 108,228     | 76,869      | 33,495      | 15,508     |
| Provision for contingent liabilities               | –  | –           | 7,841       | –           | –          |
| Total expenses                                     | 302,268                                      | 248,014     | 218,602     | 178,021     | 157,591    |
| Income (loss) before income tax expense (benefit)  | 61,382                                       | 52,242      | 37,173      | 9,187       | (14,460)   |
| Income tax expense (benefit)                       | 26,701                                       | 22,726      | 16,168      | (60,221)    | –          |
| Net income (loss)                                  | \$34,681                                     | \$29,516    | \$21,005    | \$69,408    | \$(14,460) |
| Earnings (loss) per share-basic                    | \$1.34                                       | \$1.18      | \$0.98      | \$3.56      | \$(0.76)   |
| Earnings (loss) per share-diluted                  | \$1.10                                       | \$0.92      | \$0.67      | \$2.72      | \$(0.76)   |
| Pre-tax income (loss) per share-basic (1)          | \$2.37                                       | \$2.09      | \$1.73      | \$0.47      | \$(0.76)   |
| Pre-tax income (loss) per share-diluted (2)        | \$1.94                                       | \$1.63      | \$1.18      | \$0.36      | \$(0.76)   |
| Weighted average shares outstanding-basic          | 25,935                                       | 25,040      | 21,538      | 19,473      | 19,013     |
| Weighted average shares outstanding-diluted        | 31,584                                       | 32,032      | 31,574      | 25,478      | 19,013     |
| <b>Balance Sheet Data</b>                          |  |             |             |             |            |
| Total assets                                       | \$2,142,907                                  | \$1,833,058 | \$1,396,366 | \$1,037,620 | \$890,050  |
| Cash and cash equivalents                          | 19,322                                       | 17,859      | 22,112      | 12,966      | 10,094     |
| Restricted cash and equivalents                    | 106,054                                      | 175,382     | 132,284     | 104,445     | 159,228    |
| Finance receivables, net                           | 1,909,490                                    | 1,534,496   | 1,115,437   | 744,749     | 506,279    |
| Finance receivables measured at fair value         | 61   | 1,664       | 14,476      | 59,668      | 160,253    |
| Warehouse lines of credit                          | 196,461                                      | 56,839      | 9,452       | 21,731      | 25,393     |
| Residual interest financing                        | 9,042  | 12,327      | 19,096      | 13,773      | 21,884     |
| Debt secured by receivables measured at fair value | –  | 1,250       | 13,117      | 57,107      | 166,828    |
| Securitization trust debt                          | 1,731,598                                    | 1,598,496   | 1,177,559   | 792,497     | 583,065    |
| Long-term debt                                     | 15,138                                       | 15,233      | 57,701      | 73,416      | 79,094     |
| Shareholders' equity                               | 161,159                                      | 127,253     | 94,602      | 61,311      | (14,207)   |

*Income (loss) before income tax benefit divided by weighted average shares outstanding-basic. Included for (1) illustrative purposes because some of the periods presented include significant income tax benefits while other periods have neither income tax benefit nor expense.*

*(2) Income (loss) before income tax benefit divided by weighted average shares outstanding-diluted. Included for illustrative purposes because some of the periods presented include significant income tax benefits while other*

*periods have neither income tax benefit nor expense.*

| (dollars in thousands, except per share data)   | As of and<br>For the Year Ended December 31, |             |             |           |           |  |  |  |  |
|---|--|-------------|-------------|-----------|-----------|--|--|--|--|
|   | 2015   | 2014        | 2013        | 2012      | 2011      |  |  |  |  |
| <b>Contract Purchases/Securitized</b>   |  |             |             |           |           |  |  |  |  |
| Automobile contract purchases   | \$1,060,538                                  | \$944,944   | \$764,087   | \$551,742 | \$284,236 |  |  |  |  |
| Automobile contract securitized   | 795,000                                      | 924,000     | 778,000     | 603,500   | 335,593   |  |  |  |  |
| <b>Managed Portfolio Data</b>   |  |             |             |           |           |  |  |  |  |
| Contracts held by consolidated subsidiaries   | \$2,030,652                                  | \$1,640,536 | \$1,207,694 | \$807,888 | \$546,018 |  |  |  |  |
| Fireside portfolio  | 61   | 1,664       | 14,786      | 60,804    | 172,167   |  |  |  |  |
| Contracts held by non-consolidated subsidiaries   | 40   | 390         | 4,074       | 17,298    | 42,971    |  |  |  |  |
| Third party portfolios (1)  | 383  | 1,330       | 4,868       | 11,585    | 33,493    |  |  |  |  |
| Total managed portfolio   | \$2,031,136                                  | \$1,643,920 | \$1,231,422 | \$897,575 | \$794,649 |  |  |  |  |
| Average managed portfolio   | 1,847,945                                    | 1,422,870   | 1,081,936   | 822,571   | 711,725   |  |  |  |  |
| Weighted average fixed effective interest rate (total managed portfolio) (2)  | 19.5   | % 19.8      | % 20.0      | % 19.6    | % 18.5    |  |  |  |  |
| Core operating expense (% of average managed portfolio) (3)   | 5.5  | % 6.3       | % 7.0       | % 7.9     | % 8.3     |  |  |  |  |
| Allowance for finance credit losses   | \$75,603                                     | \$61,460    | \$39,626    | \$19,594  | \$10,351  |  |  |  |  |
| Allowance for finance credit losses (% of total contracts held by consolidated subsidiaries)  | 3.7  | % 3.7       | % 3.3       | % 2.4     | % 1.9     |  |  |  |  |
| Aggregate allowance for finance credit losses and repossessions in inventory  | \$102,557                                    | \$79,289    | \$54,405    | \$25,978  | \$15,116  |  |  |  |  |
| Aggregate allowance for finance credit losses (% of total repossessions in inventory and contracts held by consolidated subsidiaries) | 5.1  | % 4.8       | % 4.5       | % 3.2     | % 2.8     |  |  |  |  |
| Total delinquencies (2) (4)   | 7.6  | % 5.5       | % 4.8       | % 4.0     | % 4.4     |  |  |  |  |
| Total delinquencies and repossessions (2) (4)   | 9.5  | % 7.2       | % 6.8       | % 5.5     | % 6.2     |  |  |  |  |
| Net charge-offs (2) (5)   | 6.4  | % 5.8       | % 4.7       | % 3.6     | % 4.8     |  |  |  |  |

(1) *Receivables related to the third party portfolios, on which we earn only a servicing fee.*

(2) *Excludes receivables related to the third party portfolios.*

(3) *Total expenses excluding provision for credit losses, provision for contingent liabilities, interest expense, loss on sale of receivables and impairment loss on residual assets.*

(4) *For further information regarding delinquencies and the managed portfolio, see the table captioned "Delinquency Experience," in Item I, Part I of this report and the notes to that table.*

(5) *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 the charge-off, including some recoveries which have been classified as other income in the accompanying consolidated financial statements. For further information regarding charge-offs, see the table captioned "Net Charge-Off Experience," in Item I, Part I of this report and the notes to that table.*





## Item 7. Management's Discussion And Analysis Of Financial Condition And Results Of Operations

The following discussion and analysis should be read in conjunction with our consolidated financial statements and notes thereto and other information included or incorporated by reference herein.

### Overview

We are a specialty finance company. 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 the customers of dealers who have limited credit histories, low incomes or past credit problems, who we refer to as sub-prime customers. 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) directly originated an immaterial amount of vehicle purchase money loans by lending money directly to consumers. 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 December 31, 2015, we have purchased a total of approximately \$12.4 billion of automobile contracts from dealers. In addition, we acquired a total of approximately \$822.3 million of automobile contracts in mergers and acquisitions in 2002, 2003, 2004 and, most recently, in September 2011. The September 2011 acquisition consisted of approximately \$217.8 million of automobile contracts that we purchased from Fireside Bank of Pleasanton, California. In 2004 and 2009, we were appointed as a third-party servicer for certain portfolios of automobile contracts originated and owned by non-affiliated entities. From 2008 through 2010, our managed portfolio decreased each year due to our strategy of limiting contract purchases to conserve our liquidity during the financial crisis and resulting recession, as discussed further below. However, since October 2009, we have gradually increased contract purchase which, in turn, has resulted in recent increases in our managed portfolio. Recent contract purchase volumes and managed portfolio levels are shown in the table below:

### Contract Purchases and Outstanding Managed Portfolio

\$ in thousands  
Year

|      | Contracts<br>Purchased<br>in Period | Managed<br>Portfolio at<br>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                             |

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 that 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 be purchased by institutional investors. 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 68 term securitizations of automobile contracts that we purchased from dealers. As of December 31, 2015, 18 of those securitizations are active and all but one are structured as secured financings. The exception is our September 2010 transaction, which 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.

Our history of term securitizations, over the most recent ten years, is summarized in the table below:

### Recent Asset-Backed Term Securitizations

| Period | \$ in thousands                         |                          |
|--------|---|--------------------------|
|        | Number<br>of<br>Term<br>Securitizations | Amount of<br>Receivables |
| 2006   | 4                                       | 957,681                  |
| 2007   | 4                                       | 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 |

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 December 31, 2015 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 December 31, 2014 included \$85.3 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 January 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 did not do a securitization in December of 2015, there was no related amount of restricted cash representing the pre-funding proceeds.

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 2014, extending the revolving period to August 2016, and adding an amortization period through August 2017. 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.

In a securitization and in our warehouse credit facilities, we are required to make certain representations and warranties, which are generally similar to the representations and warranties made by dealers in connection with our purchase of the automobile contracts. If we breach any of our representations or warranties, we will be obligated to repurchase the automobile contract at a price equal to the principal balance plus accrued and unpaid interest. We may then be entitled under the terms of our dealer agreement to require the selling dealer to repurchase the contract at a price equal to our purchase price, less any principal payments made by the customer. Subject to any recourse against dealers, we will bear the risk of loss on repossession and resale of vehicles under automobile contracts that we repurchase.

Whether a securitization is treated as a secured financing or as a sale for financial accounting purposes, the related special purpose subsidiary may be unable to release excess cash to us if the credit performance of the securitized automobile contracts falls short of pre-determined standards. Such releases represent a material portion of the cash that we use to fund our operations. An unexpected deterioration in the performance of securitized automobile contracts could therefore have a material adverse effect on both our liquidity and results of operations, regardless of whether such automobile contracts are treated as having been sold or as having been financed.

### **Credit Risk Retained**

Whether a sale of automobile contracts in connection with a securitization or warehouse credit facility is treated as a secured financing or as a sale for financial accounting purposes, the related special-purpose subsidiary may be unable to release excess cash to us if the credit performance of the related automobile contracts falls short of pre-determined standards. Such releases represent a material portion of the cash that we use to fund our operations. An unexpected deterioration in the performance of such automobile contracts could therefore have a material adverse effect on both our liquidity and our results of operations, regardless of whether such automobile contracts are treated for financial accounting purposes as having been sold or as having been financed. For estimation of the magnitude of such risk, it may be appropriate to look to the size of our "managed portfolio," which represents both financed and sold automobile contracts as to which such credit risk is retained. Our managed portfolio as of December 31, 2015 was approximately \$2,031 million.

### **Critical Accounting Policies**

We believe that our accounting policies related to (a) Allowance for Finance Credit Losses, (b) Amortization of Deferred Origination Costs and Acquisition Fees, (c) Term Securitizations, (d) Finance Receivables and Related Debt Measured at Fair Value (e) Accrual for Contingent Liabilities and (f) Income Taxes are the most critical to understanding and evaluating our reported financial results. Such policies are described below.

#### Allowance for Finance Credit Losses

In order to estimate an appropriate allowance for losses incurred on finance receivables, 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. For each monthly pool of contracts that we purchase, we begin establishing the allowance in the month of acquisition and increase it over the subsequent 11 months, through a provision for credit losses charged to our consolidated statement of operations, with the goal of establishing an allowance that approximates the next 12 months of expected net losses. Net losses incurred on finance receivables are charged to the allowance. We evaluate the adequacy of the allowance by examining current delinquencies, the characteristics of the portfolio, prospective liquidation values of the underlying collateral and general economic and market conditions. As circumstances change, our level of provisioning and/or allowance may change as well.

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. Our internal credit performance data consistently show that new receivables have lower levels of delinquency and losses early in their lives, with delinquencies increasing throughout their lives and losses gradually increasing to a peak between 36 and 42 months, after which they gradually decrease. The historical weighted average seasoning of our total owned portfolio excluding Fireside, is summarized in the table below:

| December 31, Weighted Average Age in Months of Owned Portfolio |    |
|--|----|
| 2009   | 33 |
| 2010   | 37 |
| 2011   | 27 |
| 2012   | 18 |
| 2013   | 14 |
| 2014   | 14 |
| 2015   | 16 |

The credit performance of our portfolio is also significantly influenced by our underwriting guidelines and credit criteria we use when evaluating contracts for purchase from dealers. We regularly evaluate our portfolio credit performance and modify our purchase criteria to maximize the credit performance of our portfolio, while maintaining competitive programs and levels of service for our dealers.

#### *Amortization of Deferred Originations Costs and Acquisition Fees*

Upon purchase of a contract from a dealer, we generally either charge or advance the dealer an acquisition fee. In addition, we incur certain direct costs associated with originations of our contracts. All such acquisition fees and direct costs are applied to the carrying value of finance receivables and are accreted into earnings as an adjustment to the yield over the estimated life of the contract using the interest method.

#### Term Securitizations

Our term securitization structure has generally been as follows:

We sell automobile contracts we acquire to a wholly-owned special purpose subsidiary, which has been established for the limited purpose of buying and reselling our automobile contracts. The special-purpose subsidiary then transfers the same automobile contracts to another entity, typically a statutory trust. The trust issues interest-bearing

asset-backed securities, in a principal amount equal to or less than the aggregate principal balance of the automobile contracts. We typically sell these automobile contracts to the trust at face value and without recourse, except that representations and warranties similar to those provided by the dealer to us are provided by us to the trust. One or more investors purchase the asset-backed securities issued by the trust; the proceeds from the sale of the asset-backed securities are then used to purchase the automobile contracts from us. We may retain or sell subordinated asset-backed securities issued by the trust or by a related entity. Through 2008, we generally purchased external credit enhancement for most of our term securitizations in the form of a financial guaranty insurance policy, guaranteeing timely payment of interest and ultimate payment of principal on the senior asset-backed securities, from an insurance company. We did not execute any securitizations in 2009 due to our lack of warehouse lines of credit at that time. In our 19 most recent securitizations since 2010, we have not purchased financial guaranty insurance policies and do not expect to do so in the near future.

We structure our securitizations to include internal credit enhancement for the benefit the investors (i) in the form of an initial cash deposit to an account ("spread account") held by the trust, (ii) in the form of overcollateralization of the senior asset-backed securities, where the principal balance of the senior asset-backed securities issued is less than the principal balance of the automobile contracts, (iii) in the form of subordinated asset-backed securities, or (iv) some combination of such internal credit enhancements. The agreements governing the securitization transactions require that the initial level of internal credit enhancement be supplemented by a portion of collections from the automobile contracts until the level of internal credit enhancement reaches specified levels, which are then maintained. The specified levels are generally computed as a percentage of the principal amount remaining unpaid under the related automobile contracts. The specified levels at which the internal credit enhancement is to be maintained will vary depending on the performance of the portfolios of automobile contracts held by the trusts and on other conditions, and may also be varied by agreement among us, our special purpose subsidiary, the insurance company, if any, and the trustee. Such levels have increased and decreased from time to time based on performance of the various portfolios, and have also varied from one transaction to another. The agreements governing the securitizations generally grant us the option to repurchase the sold automobile contracts from the trust when the aggregate outstanding balance of the automobile contracts has amortized to a specified percentage of the initial aggregate balance.



Our September 2008 securitization and the subsequent re-securitization of the remaining receivables from such transaction in September 2010 were each in substance sales of the underlying receivables, and have been treated as sales for financial accounting purposes. They differ from those treated as secured financings in that the trust to which our special-purpose subsidiaries sold the automobile contracts met the definition of a "qualified special-purpose entity" under Statement of Financial Accounting Standards No. 140 (ASC 860). As a result, assets and liabilities of those trusts are not consolidated into our consolidated balance sheet.

Our warehouse credit facility structures are similar to the above, except that (i) our special-purpose subsidiaries that purchase the automobile contracts pledge the automobile contracts to secure promissory notes that they issue, and (ii) no increase in the required amount of internal credit enhancement is contemplated. Our current maximum revolving warehouse financing capacity is \$300 million.

Upon each transfer of automobile contracts in a transaction structured as a secured financing for financial accounting purposes, whether a term securitization or a warehouse financing, we retain on our consolidated balance sheet the related automobile contracts as assets and record the asset-backed notes or loans issued in the transaction as indebtedness.

We receive periodic base servicing fees for the servicing and collection of the automobile contracts. Under our securitization structures treated as secured financings for financial accounting purposes, such servicing fees are included in interest income from the automobile contracts. In addition, we are entitled to the cash flows from the trusts that represent collections on the automobile contracts in excess of the amounts required to pay principal and interest on the asset-backed securities, base servicing fees, and certain other fees and expenses (such as trustee and custodial fees). Required principal payments on the asset-backed notes are generally defined as the payments sufficient to keep the principal balance of such notes equal to the aggregate principal balance of the related automobile contracts (excluding those automobile contracts that have been charged off), or a pre-determined percentage of such balance. Where that percentage is less than 100%, the related securitization agreements require accelerated payment of principal until the principal balance of the asset-backed securities is reduced to the specified percentage. Such accelerated principal payment is said to create overcollateralization of the asset-backed notes.

If the amount of cash required for payment of fees, expenses, interest and principal on the senior asset-backed notes exceeds the amount collected during the collection period, the shortfall is withdrawn from the spread account, if any. If the cash collected during the period exceeds the amount necessary for the above allocations plus required principal payments on the subordinated asset-backed notes, and there is no shortfall in the related spread account or the required overcollateralization level, the excess is released to us. If the spread account and overcollateralization is not at the required level, then the excess cash collected is retained in the trust until the specified level is achieved. Although spread account balances are held by the trusts on behalf of our special-purpose subsidiaries as the owner of the residual interests (in the case of securitization transactions structured as sales for financial accounting purposes) or the trusts (in the case of securitization transactions structured as secured financings for financial accounting purposes), we are restricted in use of the cash in the spread accounts. Cash held in the various spread accounts is invested in high quality, liquid investment securities, as specified in the securitization agreements. The interest rate payable on the

automobile contracts is significantly greater than the interest rate on the asset-backed notes. As a result, the residual interests described above historically have been a significant asset of ours.

In all of our term securitizations and warehouse credit facilities, whether treated as secured financings or as sales, we have sold the automobile contracts (through a subsidiary) to the securitization entity. The difference between the two structures is that in securitizations that are treated as secured financings we report the assets and liabilities of the securitization trust on our consolidated balance sheet. Under both structures, recourse to us by holders of the asset-backed securities and by the trust, for failure of the automobile contract obligors to make payments on a timely basis, is limited to the automobile contracts included in the securitizations or warehouse credit facilities, the spread accounts and our retained interests in the respective trusts.

#### Finance Receivables and Related Debt Measured at Fair Value

In September 2011 we purchased finance receivables from Fireside Bank. These receivables are pledged as collateral for debt that was structured specifically for the acquisition of this portfolio. Since the Fireside receivables were originated by another entity with its own underwriting guidelines and procedures, we have elected to account for the Fireside receivables and the related debt secured by those receivables at their estimated fair values so that changes in fair value will be reflected in our results of operations as they occur. There are limited observable inputs available to us for measurement of such receivables, or for the related debt. We use our own assumptions about the factors that we believe market participants would use in pricing similar receivables and debt, and are based on the best information available in the circumstances. The valuation method used to estimate fair value may produce a fair value measurement that may not be indicative of ultimate realizable value. Furthermore, while we believe our valuation methods are appropriate and consistent with those used by other market participants, the use of different methods or assumptions to estimate the fair value of certain financial instruments could result in different estimates of fair value. Those estimated values may differ significantly from the values that would have been used had a readily available market for such receivables or debt existed, or had such receivables or debt been liquidated, and those differences could be material to the financial statements.

#### Accrual 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 December 31, 2015, 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. 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 described or referenced above, as of December 31, 2015, and in excess of the liability we have recorded, is from \$0 to \$250,000.

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, 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.

## Income Taxes

We account for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities 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 judgements, significant weight is given to evidence that can be objectively verified.

Our net deferred tax asset of \$37.6 million consists of approximately \$29.9 million of net U.S. federal deferred tax assets and \$7.7 million of net state deferred tax assets. The major components of the deferred tax asset are \$13.5 million in net operating loss carryforwards and built in losses and \$24.1 million in net deductions which have not yet been taken on a tax return.

As of December 31, 2015, we had net operating loss carryforwards for state income tax purposes of \$67.3 million. These state net operating losses begin to expire in 2016.

In determining the possible future realization of deferred tax assets, we have considered future taxable income from the following sources: (a) reversal of taxable temporary differences; and (b) forecasted future net earnings from operations. Based upon those considerations, we have concluded that it is more likely than not that the U.S. and state net operating loss carryforward periods provide enough time to utilize the deferred tax assets pertaining to the existing net operating loss carryforwards and any net operating loss that would be created by the reversal of the future net deductions which have not yet been taken on a tax return. Our estimates of taxable income are forward-looking statements, and there can be no assurance that our estimates of such taxable income will be correct. Factors discussed under "Risk Factors," and in particular under the subheading "Risk Factors -- Forward-Looking Statements" may affect whether such projections prove to be correct.

We recognize interest and penalties related to unrecognized tax benefits within the income tax expense line in the accompanying consolidated statements of operations. Accrued interest and penalties are included within the related tax liability line in the consolidated balance sheets.

#### Uncertainty of Capital Markets and General Economic Conditions

We depend upon the availability of warehouse credit facilities and access to long-term financing through the issuance of asset-backed securities collateralized by our automobile contracts. Since 1994, we have completed 68 term securitizations of approximately \$10.2 billion in contracts. From the fourth quarter of 2007 through the end of 2009, we observed unprecedented adverse changes in the market for securitized pools of automobile contracts. These changes included reduced liquidity, and reduced demand for asset-backed securities, particularly for securities carrying a financial guaranty and for securities backed by sub-prime automobile receivables. Moreover, during that period many of the firms that previously provided financial guarantees, which were an integral part of our securitizations, suspended offering such guarantees. These adverse changes caused us to conserve liquidity by significantly reducing our purchases of automobile contracts. However, since September 2009 we have established new funding facilities and gradually increased our contract purchases and the frequency and amount of our term securitizations.

#### 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 securitization and non-securitization related debt contain cross-default provisions that would allow certain creditors to declare a default if a default occurred under a different facility. As of December 31, 2015 we were in compliance with all such financial covenants.

#### Results of Operations

##### *Comparison of Operating Results for the year ended December 31, 2015 with the year ended December 31, 2014*

**Revenues.** During the year ended December 31, 2015, our revenues were \$363.7 million, an increase of \$63.4 million, or 21.1%, from the prior year revenues of \$300.3 million. The primary reason for the increase in revenues is an increase in interest income. Interest income for the year ended December 31, 2015 increased \$63.2 million, or 22.0%,

to \$349.9 million from \$286.7 million in the prior year. The primary reason for the increase in interest income is the increase in finance receivables held by consolidated subsidiaries, which increased from \$1,642.2 million at December 31, 2014 to \$2,031.1 million at December 31, 2015. The table below shows the average balances of our portfolio held by consolidated subsidiaries for the year ended December 31, 2015 and 2014:

|  | <b>Average Balances<br/>for the Year Ended</b> |                      |
|--|--|----------------------|
|  | December<br>31, 2015                           | December<br>31, 2014 |
|  | Amount   | Amount               |
| Finance Receivables Owned by Consolidated Subsidiaries | (\$ in millions)                               |                      |
| CPS Originated Receivables                             | \$1,844.5                                      | \$1,414.3            |
| Fireside   | 0.4  | 5.9                  |
| Total  | \$1,844.9                                      | \$1,420.2            |

Servicing fees totaling \$319,000 in the year ended December 31, 2015 decreased \$1.1 million, or 76.8%, from \$1.4 million in the prior year. We earn base servicing fees on three portfolios that are decreasing in size as we receive customer payments and, consequently, base servicing fees are decreasing also.

At December 31, 2015, we were generating income and fees on a managed portfolio with an outstanding principal balance of \$2,031.1 million (this amount includes \$345,000 of automobile contracts on which we earn servicing fees and own a residual interest, compared to a managed portfolio with an outstanding principal balance of \$1,643.9 million as of December 31, 2014). At December 31, 2015 and 2014, the managed portfolio composition was as follows:

| Originating Entity    | December 31,<br>2015 |                  | December 31,<br>2014 |                  |
|-----------------------|----------------------|------------------|----------------------|------------------|
|                       | Amount<br>(1)        | % <sup>(2)</sup> | Amount<br>(1)        | % <sup>(2)</sup> |
|                       | (\$ in millions)     |                  |                      |                  |
| CPS                   | \$2,030.7            | 100.0%           | \$1,640.9            | 99.8 %           |
| Fireside              | 0.1                  | 0.0 %            | 1.7                  | 0.1 %            |
| Third Party Portfolio | 0.3                  | 0.0 %            | 1.3                  | 0.1 %            |
| Total                 | \$2,031.1            | 100.0%           | \$1,643.9            | 100.0%           |

(1) Contractual balances.

(2) Percentages may not add up to 100% due to rounding.

Other income increased by \$1.3 million, or 10.5%, to \$13.4 million in the year ended December 31, 2015 from \$12.1 million during the prior year. The increase consists of an increase of \$983,000 in fees associated with direct mail and other related products and services that we offer to our dealers, a net increase of \$936,000 on payments to us for our interest in certain sold charge off portfolios and acquired third-party portfolios and an increase of \$116,000 in sales tax refunds. The increases were somewhat offset by a decrease of \$690,000 in payments from third-party providers of convenience fees paid by our customers for web based and other electronic payments. In addition, in the prior year period, we incurred a markdown of \$72,000 in the fair value of the principal balance and related debt of the Fireside portfolio.

*Expenses.* Our operating expenses consist largely of provision for credit losses, interest expense, employee costs 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 \$302.3 million for the year ended December 31, 2015, compared to \$248.0 million for the prior year, an increase of \$54.3 million, or 21.9%. The increase is primarily due to the increase in the amount of new contracts we purchased the resulting increase in our consolidated portfolio and associated interest expense, servicing costs, and the related increase in our provision for credit losses.

Employee costs increased by \$9.4 million or 18.8%, to \$59.6 million during the year ended December 31, 2015, representing 19.7% of total operating expenses, from \$50.1 million for the prior year, or 20.2% of total operating expenses. Since 2010, we have added employees in our Originations and Marketing departments to accommodate the increase in contract purchases. More recently, 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 years ended, December 31, 2015 and 2014:



|   | <b>December 31, 2015</b> | <b>December 31, 2014</b> |
|---|--------------------------|--------------------------|
|   | <b>Amount</b>            | <b>Amount</b>            |
|   | <b>(\$ in millions)</b>  |                          |
| Contracts purchased (dollars)           | \$1,060.5                | \$944.9                  |
| Contracts purchased (units)             | 64,130                   | 59,276                   |
| Managed portfolio outstanding (dollars) | \$2,031.1                | \$1,643.9                |
| Managed portfolio outstanding (units)   | 149,158                  | 124,074                  |
| <br>                                    |                          |                          |
| Number of Originations staff            | 243                      | 210                      |
| Number of Marketing staff               | 140                      | 155                      |
| Number of Servicing staff               | 487                      | 445                      |
| Number of other staff                   | 65                       | 59                       |
| Total number of employees               | 935                      | 869                      |

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 \$20.2 million, an increase of \$907,000, or 4.7%, compared to the previous year and represented 6.7% of total operating expenses.

Interest expense for the year ended December 31, 2015 increased by \$7.3 million to \$57.7 million, or 14.6%, compared to \$50.4 million in the previous year.

The debt associated with the Fireside portfolio credit facility was repaid in January of 2015 resulting in a decrease of \$772,000 in interest expense compared to the prior year.

Interest on securitization trust debt increased by \$10.1 million, or 26.1%, for the year ended December 31, 2015 compared to the prior year. The increase is due primarily to the increase in the average balance of securitization trust debt, which increased 30.9% to \$1,698.8million for the year ended December 31, 2015 from \$1,298.0 million for the year ended December 31, 2014.

We repaid in full \$39.2 million in senior secured debt in the first quarter of 2014. As a result, we incurred \$1.7 million in interest expense on such debt in 2014, compared to zero in 2015. In addition, we reduced the average balance of our outstanding subordinated renewable notes by \$2.0 million from \$17.1 million at December 31, 2014 to \$15.1 million at December 31, 2015, resulting in a decrease of \$626,000 in interest expense on subordinated debt. The reduction in interest expense was also a result of our decreasing the average interest rate on our subordinated renewable notes from 12.9% for the year ended December 31, 2014 to 10.5% for the year ended December 31, 2015.

Interest expense on residual interest financing decreased \$585,000 in the year ended December 31, 2015 compared to the prior year. The decrease is due to the repayments on that facility of \$3.3 million during the year.

Interest expense on warehouse lines of credit increased by \$910,000, or 17.4% for the year ended December 31, 2015 compared to the prior year. The increase is due primarily to the increase in our contracts purchased, which increased by 12.2% from \$944.9 million in 2014 to \$1,060.5 million in 2015 and the delay of the December securitization to January 2016.

The following table presents the components of interest income and interest expense and a net interest yield analysis for the years ended December 31, 2015 and 2014:

|  | Year Ended December 31,<br>2015 |           |                                     | 2014                      |           |                                     |   |
|--|---------------------------------|-----------|-------------------------------------|---------------------------|-----------|-------------------------------------|---|
|  | (Dollars in thousands)          |           |                                     |                           |           |                                     |   |
|  | Average<br>Balance<br>(1)       | Interest  | Annualized<br>Average<br>Yield/Rate | Average<br>Balance<br>(1) | Interest  | Annualized<br>Average<br>Yield/Rate |   |
| <b><u>Interest Earning</u></b>   |                                 |           |                                     |                           |           |                                     |   |
| <b><u>Assets</u></b>   |                                 |           |                                     |                           |           |                                     |   |
| Finance receivables gross (2)  | \$1,818,644                     | \$349,465 | 19.2                                | % \$1,383,193             | \$285,169 | 20.6                                | % |
| Finance receivables measured at fair value                                       | 427                             | 447       | 104.7                               | % 5,919                   | 1,565     | 26.4                                | % |
|  | \$1,819,071                     | 349,912   | 19.2                                | % \$1,389,112             | 286,734   | 20.6                                | % |
| <b>Interest Bearing Liabilities</b>  |                                 |           |                                     |                           |           |                                     |   |
| Warehouse lines of credit  | \$62,104                        | 6,127     | 9.9                                 | % \$52,596                | 5,217     | 9.9                                 | % |
| Residual interest financing  | 10,948                          | 1,405     | 12.8                                | % 14,225                  | 1,989     | 14.0                                | % |
| Debt secured by receivables measured at fair value                               | –                               | –         |                                     | 5,561                     | 772       | 13.9                                | % |
| Securitization trust debt  | 1,698,777                       | 48,631    | 2.9                                 | % 1,298,033               | 38,558    | 3.0                                 | % |
| Senior secured debt, related party   | –                               | –         | –                                   | 9,471                     | 1,651     | 17.4                                | % |
| Subordinated renewable notes   | 15,102                          | 1,582     | 10.5                                | % 17,074                  | 2,208     | 12.9                                | % |
|  | 1,786,931                       | 57,745    | 3.2                                 | % \$1,396,960             | 50,395    | 3.6                                 | % |
| Net interest income/spread   |                                 | \$292,167 |                                     |                           | \$236,339 |                                     |   |
| Net interest margin (3)  |                                 |           | 16.1                                | %                         |           | 17.0                                | % |
| Ratio of average interest earning assets to average interest bearing liabilities | 102                             | %         |                                     | 99                        | %         |                                     |   |

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

|  | <b>Year Ended December 31, 2015<br/>Compared to December 31, 2014</b> |                                 |                               |
|--|---|---------------------------------|-------------------------------|
|  | <b>Total<br/>Change</b>   | <b>Change Due to<br/>Volume</b> | <b>Change Due to<br/>Rate</b> |
| <b><u>Interest Earning Assets</u></b>              | <b>(In thousands)</b>   |                                 |                               |
| Finance receivables gross                          | \$64,296  | \$89,776                        | \$(25,480 )                   |
| Finance receivables measured at fair value         | (1,118 )  | (1,452 )                        | ) 334                         |
|  | 63,178  | 88,324                          | (25,146 )                     |
| <b>Interest Bearing Liabilities</b>                |   |                                 |                               |
| Warehouse lines of credit                          | 910   | 943                             | (33 )                         |
| Residual interest financing                        | (584 )  | (458 )                          | ) (126 )                      |
| Debt secured by receivables measured at fair value | (772 )  | (772 )                          | ) –                           |
| Securitization trust debt                          | 10,073  | 11,904                          | (1,831 )                      |
| Senior secured debt, related party                 | (1,651 )  | (1,651 )                        | ) –                           |
| Subordinated renewable notes                       | (626 )  | (255 )                          | ) (371 )                      |
|  | 7,350   | 9,711                           | (2,361 )                      |
| Net interest income/spread                         | \$55,828  | \$78,613                        | \$(22,785 )                   |

Provision for credit losses was \$142.6 million for the year ended December 31, 2015, an increase of \$34.4 million, or 31.8% compared to the prior year and represented 47.2% 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, and also takes into account the performance of the receivables. Consequently, the increase in provision expense is the result of the increase in contract purchases during the last year, the larger portfolio owned by our consolidated subsidiaries compared to the prior year, and an adverse trend in the performance of our receivables, which we believe is consistent with the aging of our portfolio and may also be related to certain procedural changes in our servicing practices that were required by a consent decree to which we became subject in June 2014.

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 \$1.4 million, or 8.4%, to \$17.5 million during the year ended December 31, 2015, compared to \$16.1 million in the prior year, and represented 5.3% of total operating expenses. For the year ended December 31, 2015, we purchased 64,130 contracts representing \$1,060.5 million in receivables compared to 59,276 contracts representing \$944.9 million in receivables in the prior year.

Occupancy expenses increased by \$618,000 or 17.8%, to \$4.1 million compared to \$3.5 million in the previous year and represented 1.2% of total operating expenses. In July 2015, we increased our Irvine, California office by entering into a lease for additional 20,000 square feet.

Depreciation and amortization expenses increased by \$209,000 or 48.8%, to \$637,000 compared to \$428,000 in the previous year and represented 0.2% of total operating expenses.

For the year ended December 31, 2015, we recorded income tax expense of \$26.7 million, representing a 43.5% effective income tax rate. In the prior year, we recorded \$22.7 million of income tax expense, also representing a 43.5% effective income tax rate.

*Comparison of Operating Results for the year ended December 31, 2014 with the year ended December 31, 2013*

*Revenues.* In April 2013, we repurchased the outstanding Class D notes from our first 2008 securitization for a cash payment and a new note. We subsequently exercised our “clean-up call” option and repurchased the remaining collateral from the related securitization trust. The aggregate value of our consideration for the Class D notes was \$10.9 million less than our carrying value of the Class D notes at the time of the repurchase. As a result of the repurchase of the Class D notes and the termination of the securitization trust, we realized a gain of \$10.9 million, or 4.3% of our total revenues of \$255.8 million for year ended December 31, 2013. The discussion below excludes the gain of \$10.9 million for 2013 for comparative purposes.

During the year ended December 31, 2014, our revenues were \$300.3 million, an increase of \$55.4 million, or 22.6%, from the prior year revenue of \$244.8 million. The primary reason for the increase in revenues is an increase in interest income. Interest income for the year ended December 31, 2014 increased \$55.4 million, or 24.0%, to \$286.7 million from \$231.3 million in the prior year. The primary reason for the increase in interest income is the increase in finance receivables held by consolidated subsidiaries, which increased from \$1,222.5 million at December 31, 2013 to \$1,642.2 million at December 31, 2014. The table below shows the average balances of our portfolio held by consolidated subsidiaries for the year ended December 31, 2014 and 2013:

|  | <b>Average Balances<br/>for the Year Ended</b> |                      |
|--|--|----------------------|
|  | December<br>31, 2014                           | December<br>31, 2013 |
|  | Amount   | Amount               |
|  | (\$ in millions)                               |                      |
| Finance Receivables Owned by Consolidated Subsidiaries | \$1,414.3                                      | \$1,044.7            |
| CPS Originated Receivables                             | 5.9  | 31.3                 |
| Fireside   |  |                      |
| Total  | \$1,420.2                                      | \$1,076.0            |

Servicing fees totaling \$1.4 in the year ended December 31, 2014 decreased \$1.7 million, or 55.5%, from \$3.1 million in the prior year. We earn base servicing fees on three portfolios that are decreasing in size as we receive customer payments and, consequently, base servicing fees are decreasing also. As of December 31, 2014 and 2013, our managed portfolio owned by consolidated vs. non-consolidated subsidiaries and other third parties was as follows:

|  | December 31,<br>2014 |        | December 31,<br>2013 |        |
|--|----------------------|--------|----------------------|--------|
|  | Amount<br>(1)        | %(2)   | Amount<br>(1)        | %(2)   |
| Total Managed Portfolio                | (\$ in millions)     |        |                      |        |
| Owned by Consolidated Subsidiaries     |                      |        |                      |        |
| CPS Originated Receivables             | \$1,640.5            | 99.8 % | \$1,207.7            | 98.1 % |
| Fireside                               | 1.7                  | 0.1 %  | 14.8                 | 1.2 %  |
| Owned by Non-Consolidated Subsidiaries | 0.4                  | 0.0 %  | 4.0                  | 0.3 %  |
| Third-Party Servicing Portfolios       | 1.3                  | 0.1 %  | 4.9                  | 0.4 %  |
| Total                                  | \$1,643.9            | 100.0% | \$1,231.4            | 100.0% |

(1) Contractual balances.

(2) Percentages may not add up to 100% due to rounding.

At December 31, 2014, we were generating income and fees on a managed portfolio with an outstanding principal balance of \$1,643.9 million (this amount includes \$390,000 of automobile contracts on which we earn servicing fees and own a residual interest and also includes another \$1.3 million of automobile contracts on which we earn base and incentive servicing fees), compared to a managed portfolio with an outstanding principal balance of \$1,231.4 million as of December 31, 2013. At December 31, 2014 and 2013, the managed portfolio composition was as follows:

| Originating Entity    | December 31, 2014 |         | December 31, 2013 |         |
|-----------------------|-------------------|---------|-------------------|---------|
|                       | Amount (1)        | % (2)   | Amount (1)        | % (2)   |
|                       | (\$ in millions)  |         |                   |         |
| CPS                   | \$1,640.9         | 99.8 %  | \$1,211.8         | 98.4 %  |
| Fireside              | 1.7               | 0.1 %   | 14.8              | 1.2 %   |
| Third Party Portfolio | 1.3               | 0.1 %   | 4.8               | 0.4 %   |
| Total                 | \$1,643.9         | 100.0 % | \$1,231.4         | 100.0 % |

(1) Contractual balances.

(2) Percentages may not add up to 100% due to rounding.

Other income increased by \$1.7 million, or 16.7%, to \$12.1 million in the year ended December 31, 2014 from \$10.4 million during the prior year. The increase consists of a net increase of \$150,000 in the fair value of the receivables and debt associated with the Fireside portfolio acquisition, an increase of \$971,000 in fees associated with direct mail and other related products and services that we offer to our dealers, an increase of \$303,000 in sales tax refunds and an increase of \$335,000 in payments from third-party payment processors.

*Expenses.* Our operating expenses consist largely of provision for credit losses, interest expense, employee costs 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.



During the year ended December 31, 2013, we recognized \$7.8 million in contingent liability expenses to either record or increase the amounts we believe we may incur related to various pending litigation. The amount was allocated in part to a long running case we refer to as the Stanwich litigation, and also to more recent matters including two California class action suits where we are the defendant, and a governmental inquiry, in which the United States Federal Trade Commission (“FTC”) has informally proposed that we refrain from certain allegedly unfair trade practices, and make restitutionary payments into a consumer relief fund. The discussion below omits the \$7.8 million contingent liability expense from the year ended December 31, 2013 for comparative purposes.

Total operating expenses were \$248.0 million for the year ended December 31, 2014, compared to \$210.8 million for the prior year, an increase of \$37.3 million, or 17.7%. The increase is primarily due to the increase in the amount of new contracts we purchased, the resulting increase in our consolidated portfolio and associated servicing costs, and the related increase in our provision for credit losses. Increases in core operating expenses and provision for credit losses were partially offset by decreases in interest expense.

Employee costs increased by \$7.2 million or 16.7%, to \$50.1 million during the year ended December 31, 2014, representing 20.2% of total operating expenses, from \$43.0 million for the prior year, or 20.4% of total operating expenses. Since 2010, we have added employees in our Originations and Marketing departments to accommodate the increase in contract purchases. More recently, 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 years ended, December 31, 2014 and 2013:

|   | December<br>31, 2014 | December<br>31, 2013 |
|---|----------------------|----------------------|
|   | Amount               | Amount               |
|   | (\$ in millions)     |                      |
| Contracts purchased (dollars)           | \$944.9              | \$764.1              |
| Contracts purchased (units)             | 59,276               | 48,995               |
| Managed portfolio outstanding (dollars) | \$1,643.9            | \$1,231.4            |
| Managed portfolio outstanding (units)   | 124,074              | 99,842               |
| Number of Originations staff            | 210                  | 172                  |
| Number of Marketing staff               | 155                  | 119                  |
| Number of Servicing staff               | 445                  | 348                  |
| Number of other staff                   | 59                   | 66                   |
| Total number of employees               | 869                  | 705                  |

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 \$19.3 million, an increase of \$2.9 million, or 17.8%, compared to the previous year and represented 7.8% of total operating expenses.

Interest expense for the year ended December 31, 2014 decreased by \$7.8 million to \$50.4 million, or 13.4%, compared to \$58.2 million in the previous year.

Interest expense on the Fireside portfolio credit facility decreased by \$3.1 million compared to the prior year as the Fireside portfolio and the related debt have paid down to significantly lower levels over the last year.

Interest on securitization trust debt increased by \$3.8 million, or 10.9%, for the year ended December 31, 2014 compared to the prior year. Although the average balance of securitization trust debt increased 37.9% to \$1,298.0 million for the year ended December 31, 2014 from \$941.6 million for the year ended December 31, 2013, the blended interest rates on new term securitizations since 2013 have been significantly lower than in previous years. As a result, during 2014, portions of our securitization trust debt that were outstanding at December 31, 2013 at higher blended interest rates were repaid as we added new securitization trust debt at significantly lower blended interest rates.

Interest expense on senior secured debt and subordinated renewable notes decreased by \$7.4 million, or 65.6%. This was due primarily to the repayment in full of \$39.2 million in senior secured debt in the first quarter of 2014. In addition, we reduced the balance of our outstanding subordinated renewable notes by \$3.9 million from \$19.1 million at December 31, 2013 to \$15.2 million at December 31, 2014. The reduction in interest expense was also a result of our decreasing the average interest rate on our subordinated renewable notes from 14.5% for the year ended December 31, 2013 to 12.9% for the year ended December 31, 2014.

Interest expense on residual interest financing decreased \$1.3 million in the year ended December 31, 2014 compared to the prior year. The decrease is due to the repayments on that facility of \$6.8 million during the year.

Interest expense on warehouse lines of credit increased by \$214,000, or 4.3% for the year ended December 31, 2014 compared to the prior year. Although we increased our contract purchases by \$180.9 million, or 23.7%, to \$944.9 million for the year ended December 31, 2014 compared to the prior year, we attempt to minimize the use of our warehouse credit facilities and rely more on unrestricted cash balances to fund our contract purchases prior to securitization.

The following table presents the components of interest income and interest expense and a net interest yield analysis for the years ended December 31, 2014 and 2013:

|  | Year Ended December 31,<br>2014 |           |            |   | 2013        |           |            |   |
|--|---------------------------------|-----------|------------|---|-------------|-----------|------------|---|
|  | (Dollars in thousands)          |           | Annualized |   | Average     | Interest  | Annualized |   |
|  | Average                         | Interest  | Average    |   | Balance (1) | Interest  | Average    |   |
|  | Balance (1)                     |           | Yield/Rate |   |             |           | Yield/Rate |   |
| <b><u>Interest Earning Assets</u></b>  |                                 |           |            |   |             |           |            |   |
| Finance receivables gross (2)  | \$1,383,193                     | \$285,169 | 20.6       | % | \$1,015,404 | \$225,268 | 22.2       | % |
| Finance receivables measured at fair value                                       | 5,919                           | 1,565     | 26.4       | % | 31,294      | 6,062     | 19.4       | % |
|  | \$1,389,112                     | 286,734   | 20.6       | % | \$1,046,698 | 231,330   | 22.1       | % |
| <b>Interest Bearing Liabilities</b>  |                                 |           |            |   |             |           |            |   |
| Warehouse lines of credit  | \$52,596                        | 5,217     | 9.9        | % | \$40,285    | 5,003     | 12.4       | % |
| Residual interest financing  | 14,225                          | 1,989     | 14.0       | % | 24,107      | 3,330     | 13.8       | % |
| Debt secured by receivables measured at fair value                               | 5,561                           | 772       | 13.9       | % | 27,506      | 3,877     | 14.1       | % |
| Securitization trust debt  | 1,298,033                       | 38,558    | 3.0        | % | 941,591     | 34,744    | 3.7        | % |
| Senior secured debt, related party   | 9,471                           | 1,651     | 17.4       | % | 41,906      | 8,064     | 19.2       | % |
| Subordinated renewable notes   | 17,074                          | 2,208     | 12.9       | % | 21,763      | 3,161     | 14.5       | % |
|  | \$1,396,960                     | 50,395    | 3.6        | % | \$1,097,158 | 58,179    | 5.3        | % |
| Net interest income/spread   |                                 | \$236,339 |            |   |             | \$173,151 |            |   |
| Net interest margin (3)  |                                 |           | 17.0       | % |             |           | 16.5       | % |
| Ratio of average interest earning assets to average interest bearing liabilities | 99                              | %         |            |   | 95          | %         |            |   |

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

|  | <b>Year Ended December 31, 2014</b>        |                             |                           |
|--|--|-----------------------------|---------------------------|
|  | <b>Compared to December 31, 2013</b>       |                             |                           |
|  | <b>Total<br/>Change<br/>(In thousands)</b> | <b>Change Due to Volume</b> | <b>Change Due to Rate</b> |
| <u>Interest Earning Assets</u>                     |  |                             |                           |
| Finance receivables gross                          | \$59,901                                   | \$81,594                    | \$(21,693 )               |
| Finance receivables measured at fair value         | (4,497 )                                   | (4,915 )                    | ) 418                     |
|  | 55,404                                     | 76,679                      | (21,275 )                 |
| <u>Interest Bearing Liabilities</u>                |  |                             |                           |
| Warehouse lines of credit                          | 214  | 1,529                       | (1,315 )                  |
| Residual interest financing                        | (1,341 )                                   | (1,365 )                    | ) 24                      |
| Debt secured by receivables measured at fair value | (3,105 )                                   | (3,093 )                    | ) (12 )                   |
| Securitization trust debt                          | 3,814                                      | 13,152                      | (9,338 )                  |
| Senior secured debt, related party                 | (6,413 )                                   | (6,241 )                    | ) (172 )                  |
| Subordinated renewable notes                       | (953 )                                     | (681 )                      | ) (272 )                  |
|  | (7,784 )                                   | 3,301                       | (11,085 )                 |
| Net interest income/spread                         | \$63,188                                   | \$73,378                    | \$(10,190 )               |

Provision for credit losses was \$108.2 million for the year ended December 31, 2014, an increase of \$31.4 million, or 40.8% compared to the prior year and represented 43.6% 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. Consequently, the increase in provision expense is the result of the increase in contract purchases during the last year and the larger portfolio owned by our consolidated subsidiaries 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 \$2.8 million, or 20.6%, to \$16.1 million during the year ended December 31, 2014, compared to \$13.4 million in the prior year, and represented 6.5% of total operating expenses. For the year ended December 31, 2014, we purchased 59,276 contracts representing \$944.9 million in receivables compared to 48,995 contracts representing \$764.1 million in receivables in the prior year.

Occupancy expenses increased by \$856,000 or 32.8%, to \$3.5 million compared to \$2.6 million in the previous year and represented 1.4% of total operating expenses. In April 2014, we established our fifth servicing center located in Las Vegas, Nevada.

Depreciation and amortization expenses decreased by \$9,000 or 2.1%, to \$428,000 compared to \$437,000 in the previous year and represented 0.2% of total operating expenses.

For the year ended December 31, 2014, we recorded income tax expense of \$22.7 million, representing a 43.5% effective income tax rate. In the prior year, we recorded \$16.2 million of income tax expense, also representing a 43.5% effective income tax rate.

## Liquidity and Capital Resources

### Liquidity

Our business requires substantial cash to support purchases of automobile contracts and other operating activities. Our primary sources of cash have been cash flow from operating activities, including proceeds from term securitization transactions and other sales of automobile contracts, amounts borrowed under 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 securitized portfolios of automobile contracts in which we have retained a residual ownership interest and the related spread accounts. Our primary uses of cash have been the purchases of automobile contracts, repayment of securitization trust debt, repayment of amounts borrowed under warehouse credit facilities, operating expenses such as employee, interest, occupancy expenses and other general and administrative expenses, the establishment of spread accounts and initial overcollateralization, if any, and 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 portfolios and their related spread accounts), the rate of expansion or contraction in our managed portfolio, and the terms upon which we are able to purchase, sell, and borrow against automobile contracts.

Net cash provided by operating activities for the years ended December 31, 2015, 2014 and 2013 was \$187.6 million, \$135.8 million and \$99.4 million, respectively. Net cash from operating activities is generally provided by net income from operations adjusted for significant non-cash items such as our provision for credit losses, accretion of deferred acquisition fees and the \$10.9 million gain on cancellation of debt in 2013.

Net cash used in investing activities for the years ended December 31, 2015, 2014 and 2013 was \$441.3 million, \$541.2 million and \$409.6 million, respectively. Cash provided by investing activities primarily results from principal payments and other proceeds received on finance receivables held for investment. Cash used in investing activities generally relates to purchases of finance receivables. Purchases of finance receivables held for investment were \$1,060.5 million, \$944.9 million and \$764.1 million in 2015, 2014 and 2013, respectively. The results for 2015 also reflect a decrease of \$69.3 million in restricted cash. Our restricted cash balance at December 31, 2014 included \$85.3 million from the proceeds of the sale of the asset-backed notes that were held by the trustee pending delivery of the remaining receivables. Since we did not do a securitization in December of 2015, there was no related amount of restricted cash representing the pre-funding proceeds.

Net cash provided by financing activities for the years ended December 31, 2015, 2014 and 2013 was \$255.2 million, \$401.1 million and \$319.3 million, respectively. Cash used or provided by financing activities is primarily attributable to the repayment or issuance of debt, and in particular, securitization trust debt and portfolio acquisition financing. We issued \$795.0 million in new securitization trust debt in 2015 compared to \$923.0 million in 2014 and \$778.0 million in 2013. The decrease in new securitization trust debt from 2014 to 2015 is the result of our forgoing what would have been our December 2015 securitization to January 2016. Repayments of securitization debt were \$662.0 million, \$502.2 million and \$382.6 million in 2015, 2014 and 2013, respectively.

We purchase automobile contracts from dealers for a cash price approximating 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 December 31, 2015, we had unrestricted cash of \$19.3 million. We had an aggregate of \$103.5 million available under our three \$100 million warehouse credit facilities (subject to available eligible collateral). During 2015 we completed three securitizations aggregating \$795.0 million of receivables, and we intend to continue completing securitizations regularly during 2016, although there can be no assurance that we will be able to do so. 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, defaults or net losses related to the automobile contracts in the pool are below certain predetermined levels. In the event delinquencies, defaults or net losses on the automobile contracts exceed such levels, the terms of the securitization: (i) may require increased credit enhancement to be accumulated for the particular pool; or (ii) in certain circumstances, may permit the transfer of servicing on some or all of the automobile contracts to

another servicer. There can be no assurance that collections from the related trusts will continue to generate sufficient cash. Moreover, some of our spread account balances are pledged as collateral to our residual interest financing and, under certain circumstances, releases from our spread account balances could be diverted to repay such residual interest financing.

We have and will continue to have a substantial amount of indebtedness. At December 31, 2015, we had approximately \$1,952.2 million of debt outstanding. Such debt consisted primarily of \$1,731.6 million of securitization trust debt, \$196.5 million of warehouse lines of credit, \$9.0 million of residual interest financing and \$15.1 million in subordinated renewable notes. We are also currently offering the subordinated notes to the public on a continuous basis, and such notes have maturities that range from three months to 10 years.

Our recent operating results include pre-tax earnings of \$61.4 million, \$52.2 million, \$37.2 million and \$9.2 million in 2015, 2014, 2013 and 2012, respectively, 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. Failure to pay our indebtedness when due could have a material adverse effect and may require us to issue additional debt or equity securities.



## Contractual Obligations

The following table summarizes our material contractual obligations as of December 31, 2015 (dollars in thousands):

|                    | Payment Due by Period (1) |                  |              |              |                   |
|--------------------|---------------------------|------------------|--------------|--------------|-------------------|
|                    | Total                     | Less than 1 Year | 2 to 3 Years | 4 to 5 Years | More than 5 Years |
| Long Term Debt (2) | \$24,180                  | \$12,310         | 9,533        | 618          | 1,719             |
| Operating Leases   | \$33,341                  | \$4,713          | 11,528       | 9,413        | 7,687             |

Securitization trust debt, in the aggregate amount of \$1,731.6 million as of December 31, 2015, is omitted from this table because it becomes due as and when the related receivables balance is reduced by payments and (1) charge-offs. Expected payments, which will depend on the performance of such receivables, as to which there can be no assurance, are \$669.2 million in 2016, \$506.5 million in 2017, \$315.4 million in 2018, \$172.2 million in 2019, \$64.3 million in 2020, and \$4.0 million in 2021.

(2) Long-term debt includes residual interest debt and subordinated renewable notes.

For debt that is due in 2016, we anticipate repaying it with a combination of cash flows from operations and the potential issuance of new debt.

## Warehouse Credit Facilities

The terms on which credit has been available to us for purchase of automobile contracts have varied in recent years, as shown in the following summary of our warehouse credit facilities:

*Facility Established in December 2010.* In December 2010 we entered into a \$100 million two-year warehouse credit line with affiliates of Goldman, Sachs & Co. and Fortress Investment Group. The facility was structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Six Funding LLC. The facility provided for advances up to 88% of eligible finance receivables and the loans under it accrued interest at a rate of one-month LIBOR plus 5.73% per annum, with a minimum rate of 6.73% per annum. In March 2013, this facility was amended to extend the revolving period to March 2015 and to include an amortization period through March 2017 for any receivables pledged to the facility at the end of the revolving period. In March 2015, the revolving period was extended to April of 2015. We repaid the facility in full in April 2015.

*Facility Established in May 2012.* On May 11, 2012, we entered into an additional \$100 million one-year warehouse credit line with Citibank, N.A. The facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Eight Funding, LLC. The facility provides for effective advances up to 88.0% of eligible finance receivables. The loans under the facility accrue interest at one-month LIBOR plus 5.50% per annum, with a minimum rate of 6.25% per annum. In August 2014, this facility was amended to extend the revolving period to August 2016 and to include an amortization period through August 2017 for any receivables pledged to the facility at the end of the revolving period. At December 31, 2015 there was \$73.9 million outstanding under this facility.

*Facility Established in April 2015.* On April 17, 2015, we entered into an additional \$100 million one-year warehouse credit line with Fortress Investment Group. The facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Six Funding, LLC. The facility provides for effective advances up to 88.0% of eligible finance receivables. The loans under the facility accrue interest at one-month LIBOR plus 5.50% per annum, with a minimum rate of 6.50% per annum. The revolving period terminates in April 2017 followed by an amortization period through April 2019 for any receivables pledged to the facility at the end of the revolving period. At December 31, 2015 there was \$91.5 million outstanding under this facility.

*Facility Established in November 2015.* On November 24, 2015, we entered into an additional \$100 million one-year warehouse credit line with affiliates of Credit Suisse Group and Ares Management LP. The facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Nine Funding, LLC. The facility provides for effective advances up to 88.0% of eligible finance receivables, or up to 80.0% for certain other receivables. The loans under the facility accrue interest at a commercial paper rate plus 6.75% per annum, with a minimum rate of 7.75% per annum. The revolving period terminates in November 2017 followed by an amortization period through November 2019 for any receivables pledged to the facility at the end of the revolving period. At December 31, 2015 there was \$31.0 million outstanding under this facility.

## Capital Resources

Securitization trust debt is repaid from collections on the related receivables, and becomes due in accordance with its terms as the principal amount of the related receivables is reduced. Although the securitization trust debt also has alternative final maturity dates, those dates are significantly later than the dates at which repayment of the related receivables is anticipated, and at no time in our history have any of our sponsored asset-backed securities reached those alternative final maturities.

The acquisition of automobile contracts for subsequent transfer in securitization transactions, and the need to fund spread accounts and initial overcollateralization, if any, 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 trusts and related spread accounts either release cash to us or capture cash from collections on securitized automobile contracts. We plan to adjust our levels of automobile contract purchases and the related capital requirements to match anticipated releases of cash from the trusts and related spread accounts.

## Capitalization

Over the period from January 1, 2013 through December 31, 2015 we have managed our capitalization by issuing and refinancing debt as summarized in the following table:

|                                     | Year Ended December 31, |             |             |
|-------------------------------------|-------------------------|-------------|-------------|
|                                     | 2015                    | 2014        | 2013        |
|                                     | (Dollars in thousands)  |             |             |
| <b>RESIDUAL INTEREST FINANCING:</b> |                         |             |             |
| Beginning balance                   | \$12,327                | \$19,096    | \$13,773    |
| Issuances                           | –                       | –           | 20,000      |
| Payments                            | (3,285 )                | (6,769 )    | (14,677 )   |
| Ending balance                      | \$9,042                 | \$12,327    | \$19,096    |
| <b>SECURITIZATION TRUST DEBT:</b>   |                         |             |             |
| Beginning balance                   | \$1,598,496             | \$1,177,559 | \$792,497   |
| Issuances                           | 795,000                 | 923,000     | 778,000     |
| Payments                            | (661,960 )              | (502,193 )  | (382,591 )  |
| Amortization of discount            | 62                      | 130         | 600         |
| Cancellation of debt                | –                       | –           | (10,947 )   |
| Ending balance                      | \$1,731,598             | \$1,598,496 | \$1,177,559 |

SENIOR SECURED DEBT, RELATED PARTY:

|                                   |     |           |           |
|-----------------------------------|-----|-----------|-----------|
| Beginning balance                 | \$- | \$38,559  | \$50,135  |
| Issuances                         | -   | -         | 5,284     |
| Payments                          | -   | (39,182 ) | (18,852 ) |
| Debt discount net of amortization | -   | 623       | 1,992     |
| Ending balance                    | \$- | \$-       | \$38,559  |

SUBORDINATED RENEWABLE NOTES:

|                   |          |          |          |
|-------------------|----------|----------|----------|
| Beginning balance | \$15,233 | \$19,142 | \$23,281 |
| Issuances         | 1,551    | 579      | 1,276    |
| Payments          | (1,646 ) | (4,488 ) | (5,415 ) |
| Ending balance    | \$15,138 | \$15,233 | \$19,142 |

DEBT SECURED BY RECEIVABLES MEASURED AT FAIR VALUE:

|                      |          |           |           |
|----------------------|----------|-----------|-----------|
| Beginning balance    | \$1,250  | \$13,117  | \$57,107  |
| Payments             | (1,250 ) | (12,456 ) | (45,969 ) |
| Accretion of premium | -        | 712       | 2,726     |
| Mark to fair value   | -        | (123 )    | (747 )    |
| Ending balance       | \$-      | \$1,250   | \$13,117  |

*Residual Interest Financing.*

In April 2013, we established a five-year \$20 million term residual facility. The facility is secured by eligible residual interests in two previously securitized pools of automobile receivables. The facility provides for effective advances up to 70.0% of the related borrowing base. Notes issued under the facility accrue interest at one-month LIBOR plus 11.75% per annum. At December 31, 2015, there was \$9.0 million outstanding under this facility.

*Securitization Trust Debt.* From July 2003 through April 2008, we treated all securitizations of automobile contracts as secured financings for financial accounting purposes, and the asset-backed securities issued in such securitizations remain on our consolidated balance sheet as securitization trust debt. Our September 2008 and the re-securitization of the remaining receivables from such transaction in September 2010 were each structured as a sale for financial accounting purposes and the asset-backed securities issued in those transactions have not been and are not on our consolidated balance sheet. Since 2011 all 18 of our securitizations have been treated as secured financings and make up \$1,731.6 million of our securitization trust debt at December 31, 2015.

*Subordinated Renewable Notes Debt.* In June 2005, we began issuing registered subordinated renewable notes in an ongoing offering to the public. Upon maturity, the notes are automatically renewed for the same term as the maturing notes, unless we repay the notes or the investor notifies us within 15 days after the maturity date of his note that he wants it repaid. Renewed notes bear interest at the rate we are offering at that time to other investors with similar note maturities. Based on the terms of the individual notes, interest payments may be required monthly, quarterly, annually or upon maturity. At December 31, 2015 there were \$15.1 million of such notes outstanding.

We must comply with certain affirmative and negative covenants related to debt facilities, which require, among other things, that we maintain certain financial ratios related to liquidity, net worth, capitalization, investments, acquisitions, restricted payments and certain dividend restrictions. In addition, certain securitization and non-securitization related debt contain cross-default provisions that would allow certain creditors to declare default if a default occurred under a different facility. As of December 31, 2015, we were in compliance with all such covenants.

Forward-looking Statements

This report on Form 10-K 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. As to the specifically identified forward-looking statements, 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 contracts, changes in laws respecting consumer finance, which could affect our ability to enforce rights under 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 contracts, which would affect our ability to purchase contracts, the terms on which we are able to finance such purchases, the willingness of dealers to sell contracts to us on the terms that it offers, and the terms on which we are able to complete term securitizations once contracts are acquired. Factors that could affect our expenses in the current year include competitive conditions in the market for qualified personnel, investor demand for asset-backed securities and interest rates (which affect the rates that we pay on asset-backed securities issued in our securitizations). The statements concerning structuring securitization transactions as secured financings and the effects of such structures on financial items and on future profitability also are forward-looking statements. Any change to the structure of our securitization transaction could cause such forward-looking statements to be inaccurate. Both the amount of the effect of the change in structure on our profitability and the duration of the period in which our profitability would be affected by the change in securitization structure are estimates. The accuracy of such estimates will be affected by the rate at which we purchase and sell contracts, any changes in that rate, the credit performance of such contracts, the financial terms of future securitizations, any changes in such terms over time, and other factors that generally affect our profitability.

#### Item 7A. Quantitative and Qualitative Disclosures About Market Risk

##### Interest Rate Risk

We are subject to interest rate risk during the period between when contracts are purchased from dealers and when such contracts become part of a term securitization. Specifically, the interest rate due on our warehouse credit facilities are adjustable while the interest rates on the contracts are fixed. Therefore, if interest rates increase, the interest we must pay to our lenders under warehouse credit facilities is likely to increase while the interest we receive from warehoused automobile contracts remains the same. As a result, excess spread cash flow would likely decrease during the warehousing period. Additionally, automobile contracts warehoused and then securitized during a rising interest rate environment may result in less excess spread cash flow to us. Historically, our securitization facilities have paid fixed rate interest to security holders set at prevailing interest rates at the time of the closing of the securitization, which may not take place until several months after we purchased those contracts. Our customers, on the other hand, pay fixed rates of interest on the automobile contracts, set at the time they purchase the underlying vehicles. A decrease in excess spread cash flow could adversely affect our earnings and cash flow.

To mitigate, but not eliminate, the short-term risk relating to interest rates payable under the warehouse facilities, we have historically held automobile contracts in the warehouse credit facilities for less than four months. To mitigate, but not eliminate, the long-term risk relating to interest rates payable by us in securitizations, we have structured our term securitization transactions to include pre-funding structures, whereby the amount of notes issued exceeds the amount of contracts initially sold to the trusts. We expect to continue to use pre-funding structures in our securitizations. In pre-funding, the proceeds from the pre-funded portion are held in an escrow account until we sell the additional contracts to the trust. In pre-funded securitizations, we lock in the borrowing costs with respect to the contracts we subsequently deliver to the securitization trust. However, we incur an expense in pre-funded securitizations equal to the difference between the money market yields earned on the proceeds held in escrow prior to subsequent delivery of contracts and the interest rate paid on the notes outstanding. The amount of such expense may vary. Despite these mitigation strategies, an increase in prevailing interest rates would cause us to receive less excess spread cash flows on automobile contracts, and thus could adversely affect our earnings and cash flows.

#### Item 8. Financial Statements and Supplementary Data

This report includes Consolidated Financial Statements, notes thereto and an Independent Auditors' Report, at the pages indicated below, in the "Index to Financial Statements."

#### Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Not applicable.

#### Item 9A. Controls and Procedures

*Disclosure Controls and Procedures.* Under the supervision and with the participation of the Company's Chief Executive Officer and Chief Financial Officer, management of the Company has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act") as of December 31, 2015 (the "Evaluation Date"). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures are effective (i) to ensure that information required

to be disclosed by us in reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission; and (ii) to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to our management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures. The certifications of our chief executive officer and chief financial officer required under Section 302 of the Sarbanes-Oxley Act have been filed as Exhibits 31.1 and 31.2 to this report.

*Internal Control.* Management's Report on Internal Control over Financial Reporting is included in this Annual Report, immediately below. During the fiscal quarter ended December 31, 2015, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

*Management's Report on Internal Control over Financial Reporting.* We are responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. Our internal control over financial reporting is designed to provide reasonable assurance to our management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can only provide reasonable assurance with respect to financial statement preparation and presentation.

Management, with the participation of the chief executive and chief financial officers, assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in the 2013 Internal Control — Integrated Framework. Based on this assessment, management, with the participation of the chief executive and chief financial officers, believes that, as of December 31, 2015, our internal control over financial reporting is effective based on those criteria.

Our internal control over financial reporting as of December 31, 2015, has been audited by Crowe Horwath LLP, an independent registered public accounting firm, as stated in their report which is included herein.

#### Item 9B. Other Information

Not Applicable.





PART III

Item 10. Directors and Executive Officers and Corporate Governance

Information regarding directors of the registrant is incorporated by reference to the registrant's definitive proxy statement for its annual meeting of shareholders to be held in 2016 (the "2016 Proxy Statement"). The 2016 Proxy Statement will be filed not later than April 30, 2016. Information regarding executive officers of the registrant appears in Part I of this report, and is incorporated herein by reference.

Item 11. Executive Compensation

Incorporated by reference to the 2016 Proxy Statement.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Incorporated by reference to the 2016 Proxy Statement.

Item 13. Certain Relationships and Related Transactions, and Director Independence

Incorporated by reference to the 2016 Proxy Statement.

Item 14. Principal Accountant Fees and Services

Incorporated by reference to the 2016 Proxy Statement.

## PART IV

## Item 15. Exhibits, Financial Statement Schedules

The financial statements listed below under the caption "Index to Financial Statements" are filed as a part of this report. No financial statement schedules are filed as the required information is inapplicable or the information is presented in the Consolidated Financial Statements or the related notes. Separate financial statements of the Company have been omitted as the Company is primarily an operating company and its subsidiaries are wholly owned and do not have minority equity interests held by any person other than the Company in amounts that together exceed 5% of the total consolidated assets as shown by the most recent year-end Consolidated Balance Sheet.

The exhibits listed below are filed as part of this report, whether filed herewith or incorporated by reference to an exhibit filed with the report identified in the parentheses following the description of such exhibit. Unless otherwise indicated, each such identified report was filed by or with respect to the registrant.

| <i>Exhibit<br/>Number</i> | <i>Description</i> ( <i>“**” indicates compensatory plan or agreement.</i> )   |
|---------------------------|--|
| 3.1                       | Restated Articles of Incorporation (Exhibit 3.1 to Form 10-K filed March 31, 2009)   |
| 3.1.1                     | Certificate of Designation re Series B Preferred (Exhibit 3.1.1 to Form 8-K filed by the registrant on December 30, 2010)  |
| 3.2                       | Amended and Restated Bylaws (Exhibit 3.3 to Form 8-K filed July 20, 2009)  |
| 4.                        | 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. |
| 4.1                       | Form of Indenture re Renewable Unsecured Subordinated Notes (“RUS Notes”). (Exhibit 4.1 to Form S-2, no. 333-121913)   |
| 4.2.1                     | Form of RUS Notes (Exhibit 4.2 to Form S-2, no. 333-121913)  |
| 4.3                       | Form of Indenture re additional Renewable Unsecured Subordinated Notes (“ARUS Notes”) (Exhibit 4.1 to Form S-1, no. 333-168976)  |
| 4.3.1                     | Form of ARUS Notes (Exhibit 4.2 to Form S-1, no. 333-168976)   |
| 4.4                       | Supplement dated December 7, 2010 to Indenture re ARUS Notes (Exhibit 4.3 to Form S-1, no. 333-168976)   |
| 4.4                       | Supplement dated January 22, 2014 to Indenture re ARUS Notes (Exhibit 4.4 to Form S-1, no. 333-190766)   |
| 4.61                      | Indenture re Notes issued by CPS Auto Receivables Trust 2015-B (exhibit 4.61 to Form 8-K/A filed by the registrant on June 26, 2015)   |
| 4.62                      | Sale and Servicing Agreement dated as of June 1, 2015, related to notes issued by CPS Auto Receivables Trust 2015-B (exhibit 4.62 to Form 8-K/A filed by the registrant on June 26, 2015)  |

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- 4.63 Indenture re Notes issued by CPS Auto Receivables Trust 2015-C (exhibit 4.63 to Form 8-K filed by the registrant on September 22, 2015)
- 4.64 Sale and Servicing Agreement dated as of September 1, 2015, related to notes issued by CPS Auto Receivables Trust 2015-C (exhibit 4.64 to Form 8-K filed by the registrant on September 22, 2015)
- 10.2 1997 Long-Term Incentive Stock Plan ("1997 Plan") (Exhibit 10.20 to Form S-2, no. 333-121913) \*\*
- 10.2.1 Form of Option Agreement under 1997 Plan (Exhibit 10.2.1 to Form 10-K filed March 13, 2006) \*\*
- 10.14 2006 Long-Term Equity Incentive Plan as amended May 18, 2015 (Incorporated by reference to pages A-1 through A-10 of the definitive proxy statement filed by the registrant on April 27, 2015)\*\*
- 10.14.1 Form of Option Agreement under the 2006 Long-Term Equity Incentive Plan (Exhibit 10.14.1 to registrant's Form 10-K filed March 9, 2007)\*\*
- 10.14.2 Form of Option Agreement under the 2006 Long-Term Equity Incentive Plan (Exhibit 99.(D)(2) to registrant's Schedule TO filed November 12, 2009)\*\*
- 10.14.2 Form of Option Agreement under the 2006 Long-Term Equity Incentive Plan (Exhibit 99.(D)(3) to registrant's Schedule TO filed November 12, 2009)\*\*
- 10.23 Warrant dated July 10, 2008, issued to Citigroup Global Markets Inc. (Exhibit 10.23 to registrant's Form 10-Q filed August 11, 2008)
- 10.61 Revolving Credit Agreement dated April 17, 2015 among the registrant, its subsidiary Page Six Funding, LLC, and Fortress Credit Co LLC ("Fortress") (Exhibit 10.61 to registrant's Form 8-K filed April 23, 2015)
- 10.62 Receivables Purchase Agreement dated April 17, 2015 between the registrant and its subsidiary Page Six Funding, LLC (Exhibit 10.62 to registrant's Form 8-K filed April 23, 2015)
- 10.63 Third Amended and Restated Credit Agreement dated December 2, 2014 among the registrant, its subsidiary Page Eight Funding, LLC, and Citibank, N.A. (to be filed by amendment)
- 10.64 Revolving Credit Agreement dated November 24, 2015 among the registrant, its subsidiary Page Nine Funding, LLC, Credit Suisse AG, New York Branch, and Ares Agent Services, L.P. (to be filed by amendment)
- 10.65 Receivables Purchase Agreement dated November 24, 2015 between the registrant and its subsidiary Page Nine Funding, LLC (to be filed by amendment)
- 14 Registrant's Code of Ethics for Senior Financial Officers (Exhibit 14 to Form 10-K filed March 13, 2006)
- 21 List of subsidiaries of the registrant (Exhibit 21 to Form 10-K filed March 10, 2014)
- 23.1 Consent of Crowe Horwath LLP (filed herewith)
- 31.1 Rule 13a-14(a) certification by chief executive officer (filed herewith)
- 31.2 Rule 13a-14(a) certification by chief financial officer (filed herewith)
- 32 Section 1350 certification (filed herewith)

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**CONSUMER PORTFOLIO  
SERVICES, INC. (registrant)**

March 9, 2016 By: /s/ CHARLES E. BRADLEY, JR.  
Charles E. Bradley, Jr., *President*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

March 9, 2016 /s/ CHARLES E. BRADLEY, JR.  
Charles E. Bradley, Jr., *Director*,  
  
*President and Chief Executive Officer*  
  
*(Principal Executive Officer)*

March 9, 2016 /s/ CHRIS A. ADAMS  
  
Chris A. Adams, *Director*

March 9, 2016 /s/ BRIAN J. RAYHILL  
  
Brian J. Rayhill, *Director*

March 9, 2016 /s/ WILLIAM B. ROBERTS  
William B. Roberts, *Director*

March 9, 2016 /s/ GREGORY S. WASHER

Gregory S. Washer, *Director*

March 9, 2016 /s/ DANIEL S. WOOD

Daniel S. Wood, *Director*

March 9, 2016 /s/ JEFFREY P. FRITZ

Jeffrey P. Fritz, *Executive Vice President and Chief Financial Officer*

*(Principal Accounting Officer)*

INDEX TO FINANCIAL STATEMENTS

|  | <b><u>Page<br/>Reference</u></b> |
|--|----------------------------------|
| Report of Independent Registered Public Accounting Firm  | F-2                              |
| Consolidated Balance Sheets as of December 31, 2015 and 2014   | F-3                              |
| Consolidated Statements of Income for the years ended December 31, 2015, 2014 and 2013               | F-4                              |
| Consolidated Statements of Comprehensive Income for the years ended December 31, 2015, 2014 and 2013 | F-5                              |
| Consolidated Statements of Shareholders' Equity for the years ended December 31, 2015, 2014 and 2013 | F-6                              |
| Consolidated Statements of Cash Flows for the years ended December 31, 2015, 2014 and 2013           | F-7                              |
| Notes to Consolidated Financial Statements.  | F-9                              |

F-1



REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders

Consumer Portfolio Services, Inc.

Las Vegas, Nevada

We have audited the accompanying consolidated balance sheets of Consumer Portfolio Services, Inc. and Subsidiaries (the Company) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2015. We also have audited the Company's internal control over financial reporting as of December 31, 2015, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance

with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Consumer Portfolio Services, Inc. and Subsidiaries as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, Consumer Portfolio Services, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ CROWE HORWATH LLP

Sherman Oaks, California

March 9, 2016

F-2

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

**(In thousands, except share and per share data)**

|   | December<br>31,<br>2015 | December<br>31,<br>2014 |
|---|-------------------------|-------------------------|
| <b>ASSETS</b>   |                         |                         |
| Cash and cash equivalents   | \$19,322                | \$17,859                |
| Restricted cash and equivalents   | 106,054                 | 175,382                 |
| Finance receivables   | 1,985,093               | 1,595,956               |
| Less: Allowance for finance credit losses   | (75,603 )               | (61,460 )               |
| Finance receivables, net  | 1,909,490               | 1,534,496               |
| Finance receivables measured at fair value  | 61                      | 1,664                   |
| Furniture and equipment, net  | 1,715                   | 1,161                   |
| Deferred financing costs  | 13,982                  | 12,362                  |
| Deferred tax assets, net  | 37,597                  | 42,847                  |
| Accrued interest receivable   | 31,547                  | 23,372                  |
| Other assets  | 23,139                  | 23,915                  |
|   | <b>\$2,142,907</b>      | <b>\$1,833,058</b>      |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                         |                         |
| <b>Liabilities</b>  |                         |                         |
| Accounts payable and accrued expenses   | \$29,509                | \$21,660                |
| Warehouse lines of credit   | 196,461                 | 56,839                  |
| Residual interest financing   | 9,042                   | 12,327                  |
| Debt secured by receivables measured at fair value  | -                       | 1,250                   |
| Securitization trust debt   | 1,731,598               | 1,598,496               |
| Subordinated renewable notes  | 15,138                  | 15,233                  |
|   | 1,981,748               | 1,705,805               |
| Commitments and contingencies   |                         |                         |
| <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; 25,616,460 and 25,540,640 shares issued and outstanding at December 31, 2015 and 2014, respectively | 81,337                  | 80,513                  |
| Retained earnings   | 86,472                  | 51,791                  |
| Accumulated other comprehensive loss  | (6,650 )                | (5,051 )                |
|   | 161,159                 | 127,253                 |
|   | <b>\$2,142,907</b>      | <b>\$1,833,058</b>      |

*See accompanying Notes to Consolidated Financial Statements.*

F-3

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF INCOME

**(In thousands, except per share data)**

|  | Year Ended December 31, |           |           |
|--|-------------------------|-----------|-----------|
|  | 2015                    | 2014      | 2013      |
| Revenues:  |                         |           |           |
| Interest income  | \$349,912               | \$286,734 | \$231,330 |
| Servicing fees   | 319                     | 1,376     | 3,093     |
| Other income   | 13,419                  | 12,146    | 10,405    |
| Gain on cancellation of debt                           | –                       | –         | 10,947    |
|  | 363,650                 | 300,256   | 255,775   |
| Expenses:  |                         |           |           |
| Employee costs   | 59,556                  | 50,129    | 42,960    |
| General and administrative                             | 20,160                  | 19,254    | 16,345    |
| Interest   | 57,745                  | 50,395    | 58,179    |
| Provision for credit losses                            | 142,618                 | 108,228   | 76,869    |
| Provision for contingent liabilities                   | –                       | –         | 7,841     |
| Marketing  | 17,470                  | 16,116    | 13,363    |
| Occupancy  | 4,082                   | 3,464     | 2,608     |
| Depreciation and amortization                          | 637                     | 428       | 437       |
|  | 302,268                 | 248,014   | 218,602   |
| Income before income tax expense                       | 61,382                  | 52,242    | 37,173    |
| Income tax expense                                     | 26,701                  | 22,726    | 16,168    |
| Net income   | \$34,681                | \$29,516  | \$21,005  |
| Earnings per share:                                    |                         |           |           |
| Basic  | \$1.34                  | \$1.18    | \$0.98    |
| Diluted  | 1.10                    | 0.92      | 0.67      |
| Number of shares used in computing earnings per share: |                         |           |           |
| Basic  | 25,935                  | 25,040    | 21,538    |
| Diluted  | 31,584                  | 32,032    | 31,574    |

*See accompanying Notes to Consolidated Financial Statements.*

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

|  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2015                    | 2014     | 2013     |
| Net income   | \$34,681                | \$29,516 | \$21,005 |
| Other comprehensive income (loss); change in funded status of pension plan, net of (\$1,016), (\$2,654) and \$3,044 in tax for 2015, 2014 and 2013, respectively | (1,599)                 | (3,956)  | 4,542    |
| Comprehensive income   | \$33,082                | \$25,560 | \$25,547 |

*See accompanying Notes to Consolidated Financial Statements.*

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

**(In thousands)**

|   | Common Stock<br>Shares | Common Stock<br>Amount | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total       |
|---|------------------------|------------------------|----------------------|---|-------------|
| Balance at January 1, 2013                                | 19,839                 | \$65,678               | \$1,270              | \$ (5,637)                                    | ) \$61,311  |
| Common stock issued upon exercise of options and warrants | 4,177                  | 3,297                  | —                    | —   | 3,297       |
| Pension benefit obligation                                | —                      | —                      | —                    | 4,542   | 4,542       |
| Stock-based compensation                                  | —                      | 3,864                  | —                    | —   | 3,864       |
| Reclassification of warrants from debt                    | —                      | 583                    | —                    | —   | 583         |
| Net income  | —                      | —                      | 21,005               | —   | 21,005      |
| Balance at December 31, 2013                              | 24,016                 | \$73,422               | \$22,275             | \$ (1,095)                                    | ) \$94,602  |
| Common stock issued upon exercise of options and warrants | 1,525                  | 3,256                  | —                    | —   | 3,256       |
| Pension benefit obligation                                | —                      | —                      | —                    | (3,956)                                       | ) (3,956)   |
| Stock-based compensation                                  | —                      | 3,835                  | —                    | —   | 3,835       |
| Net income  | —                      | —                      | 29,516               | —   | 29,516      |
| Balance at December 31, 2014                              | 25,541                 | \$80,513               | \$51,791             | \$ (5,051)                                    | ) \$127,253 |
| Common stock issued upon exercise of options and warrants | 1,140                  | 1,726                  | —                    | —   | 1,726       |
| Repurchase of common stock                                | (1,064)                | (5,926)                | —                    | —   | (5,926)     |
| Pension benefit obligation                                | —                      | —                      | —                    | (1,599)                                       | ) (1,599)   |
| Stock-based compensation                                  | —                      | 5,024                  | —                    | —   | 5,024       |
| Net income  | —                      | —                      | 34,681               | —   | 34,681      |
| Balance at December 31, 2015                              | 25,617                 | \$81,337               | \$86,472             | \$ (6,650)                                    | ) \$161,159 |

*See accompanying Notes to Consolidated Financial Statements.*

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|   | Year Ended December 31, |           |           |
|---|-------------------------|-----------|-----------|
|   | 2015                    | 2014      | 2013      |
| Cash flows from operating activities:   |                         |           |           |
| Net income  | \$34,681                | \$29,516  | \$21,005  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                         |           |           |
| Accretion of deferred acquisition fees  | (8,954 )                | (16,213 ) | (20,565 ) |
| Accretion of purchase discount on receivables measured at fair value              | –                       | (283 )    | (1,421 )  |
| Amortization of discount on securitization trust debt                             | 62                      | 130       | 600       |
| Amortization of discount on senior secured debt, related party                    | –                       | 623       | 1,992     |
| Accretion of premium on debt secured by receivables measured at fair value        | –                       | 712       | 2,726     |
| Mark to fair value on debt secured by receivables at fair value                   | –                       | (123 )    | (747 )    |
| Mark to fair value of receivables at fair value                                   | –                       | (27 )     | 595       |
| Depreciation and amortization   | 637                     | 428       | 437       |
| Amortization of deferred financing costs  | 7,017                   | 6,767     | 6,803     |
| Provision for credit losses   | 142,618                 | 108,228   | 76,869    |
| Provision for contingent liabilities  | –                       | –         | 7,841     |
| Stock-based compensation expense  | 5,024                   | 3,835     | 3,864     |
| Interest income on residual assets  | (92 )                   | (372 )    | –         |
| Gain on cancellation of debt  | –                       | –         | (10,947 ) |
| Changes in assets and liabilities:  |                         |           |           |
| Accrued interest receivable   | (8,175 )                | (4,702 )  | (8,259 )  |
| Other assets  | 3,237                   | (1,925 )  | (2,183 )  |
| Deferred tax assets, net  | 5,250                   | 16,368    | 16,425    |
| Accounts payable and accrued expenses   | 6,250                   | (7,135 )  | 4,337     |
| Net cash provided by operating activities   | 187,555                 | 135,827   | 99,372    |
| Cash flows from investing activities:   |                         |           |           |
| Purchases of finance receivables held for investment                              | (1,060,538)             | (944,944) | (764,087) |
| Payments received on finance receivables held for investment                      | 551,880                 | 433,870   | 337,095   |
| Payments on receivables portfolio at fair value                                   | 1,603                   | 13,122    | 46,018    |
| Proceeds received on residual interest in securitizations                         | –                       | 1,158     | 3,970     |
| Change in repossessions held in inventory   | (2,369 )                | (441 )    | (4,246 )  |
| Decreases (increases) in restricted cash and cash equivalents, net                | 69,328                  | (43,098 ) | (27,839 ) |
| Purchase of furniture and equipment   | (1,191 )                | (823 )    | (477 )    |
| Net cash used in investing activities   | (441,287 )              | (541,156) | (409,566) |
| Cash flows from financing activities:   |                         |           |           |
| Proceeds from issuance of securitization trust debt                               | 795,000                 | 923,000   | 778,000   |
| Proceeds from issuance of subordinated renewable notes                            | 1,551                   | 579       | 1,276     |



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|  |            |           |           |
|--|------------|-----------|-----------|
| Proceeds from issuance of senior secured debt, related party       | –          | –         | 5,284     |
| Payments on subordinated renewable notes                           | (1,646 )   | (4,488 )  | (5,415 )  |
| Net proceeds from (repayments of) warehouse lines of credit        | 139,622    | 47,387    | (12,279 ) |
| Net proceeds from (repayments of) residual interest financing debt | (3,285 )   | (6,769 )  | 5,323     |
| Repayment of securitization trust debt                             | (661,960 ) | (502,193) | (382,591) |
| Repayment of debt secured by receivables measured at fair value    | (1,250 )   | (12,456 ) | (45,969 ) |
| Repayment of senior secured debt, related party                    | –          | (39,182 ) | (18,852 ) |
| Payment of financing costs   | (8,637 )   | (8,058 )  | (8,734 )  |
| Repurchase of common stock   | (5,926 )   | –         | –         |
| Exercise of options and warrants                                   | 1,726      | 3,256     | 3,297     |
| Net cash provided by financing activities                          | 255,195    | 401,076   | 319,340   |
| Increase (decrease) in cash and cash equivalents                   | 1,463      | (4,253 )  | 9,146     |
| Cash and cash equivalents at beginning of year                     | 17,859     | 22,112    | 12,966    |
| Cash and cash equivalents at end of year                           | \$19,322   | \$17,859  | \$22,112  |

*See accompanying Notes to Consolidated Financial Statements.*

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

**CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

|  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2015                    | 2014     | 2013     |
| Supplemental disclosure of cash flow information:                                |                         |          |          |
| Cash paid during the period for:   |                         |          |          |
| Interest   | \$50,019                | \$45,914 | \$50,663 |
| Income taxes   | 13,690                  | 6,520    | 2,277    |
| Non-cash financing activities:   |                         |          |          |
| Pension benefit obligation, net  | 1,599                   | 3,956    | (4,542 ) |
| Derivative warrants reclassified from liabilities to common stock upon amendment | —                       | —        | 583      |

*See accompanying Notes to Consolidated Financial Statements.*

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(1) Summary of Significant Accounting Policies*

Description of Business

Consumer Portfolio Services, Inc. ("CPS") was incorporated in California on March 8, 1991. CPS and its subsidiaries (collectively, the "Company") specialize in purchasing and servicing retail automobile installment sale contracts ("Contracts") originated by licensed motor vehicle dealers ("Dealers") located throughout the United States. Dealers located in California, Texas, Ohio, Florida and Georgia represented 8.9%, 7.9%, 6.5%, 5.3% and 5.2%, respectively, of contracts purchased during 2015 compared with 8.7%, 10.0%, 5.7%, 5.0%, and 4.4% respectively in 2014. No other state had a concentration in excess of 5.0% in 2015. We specialize in contracts with vehicle purchasers who generally would not be expected to qualify for traditional financing provided by commercial banks or automobile manufacturers' captive finance companies.

We are subject to various regulations and laws as they relate to the extension of credit in consumer credit transactions. Failure to comply with such laws and regulations could have a material adverse effect on the Company.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Consumer Portfolio Services, Inc. and its wholly-owned subsidiaries, certain of which are special purpose subsidiaries ("SPS"), formed to accommodate the structures under which we purchase and securitize our contracts. The Consolidated Financial Statements also include the accounts of CPS Leasing, Inc., an 80% owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Cash and Cash Equivalents

For purposes of the statements of cash flows, we consider all highly liquid debt instruments with original maturities of three months or less to be cash equivalents. Cash equivalents consist of cash on hand and due from banks and money

market accounts. Substantially all of our cash is deposited at three financial institutions. We maintain cash due from banks in excess of the banks' insured deposit limits. We do not believe we are exposed to any significant credit risk on these deposits. As part of certain financial covenants related to debt facilities, we are required to maintain a minimum unrestricted cash balance. As of December 31, 2015, our unrestricted cash balance was \$19.3 million, which exceeded the minimum amounts required by our financial covenants.

#### Finance Receivables

Finance receivables, which we have the intent and ability to hold for the foreseeable future or until maturity or payoff, are presented at cost. All finance receivable contracts are held for investment. Interest income is accrued on the unpaid principal balance. Origination fees, net of certain direct origination costs, are deferred and recognized in interest income using the interest method without anticipating prepayments. Generally, payments received on finance receivables are restricted to certain securitized pools, and the related contracts cannot be resold. Finance receivables are charged off pursuant to the controlling documents of certain securitized pools, generally as described below under Charge Off Policy. Management may authorize an extension of payment terms if collection appears likely during the next calendar month.

Our portfolio of finance receivables consists of small-balance homogeneous contracts that are collectively evaluated for impairment on a portfolio basis. 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.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Allowance for Finance Credit Losses

In order to estimate an appropriate allowance for losses likely incurred on finance receivables, we use a loss allowance methodology commonly referred to as "static pooling," which stratifies the finance receivable portfolio into separately identified pools based on their period of origination, then uses historical performance of seasoned pools to estimate future losses on current pools. Historical loss experience is adjusted as necessary for current economic conditions. We consider our portfolio of finance receivables to be relatively homogenous and consequently we analyze credit performance primarily in the aggregate rather than stratification by any particular credit quality indicator. 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 finance receivable contracts. For each monthly pool of contracts that we purchase, we begin establishing the allowance in the month of acquisition and increase it over the subsequent 11 months, through a provision for credit losses charged to our Consolidated Statement of Income. Net losses incurred on finance receivables are charged to the allowance. We evaluate the adequacy of the allowance by examining current delinquencies, the characteristics of the portfolio, the value of the underlying collateral and historical loss trends. As conditions change, our level of provisioning and/or allowance may change.

Finance Receivables and Related Debt Measured at Fair Value

In September 2011, we acquired \$217.8 million of finance receivables from Fireside Bank for a purchase price of \$201.3 million. The receivables were acquired by our wholly-owned special purpose subsidiary, CPS Fender Receivables, LLC, which issued a note for \$197.3 million, with a fair value of \$196.5 million.

The receivables we acquired are pledged as collateral for debt that was structured specifically for the acquisition of this portfolio. Since the Fireside receivables were originated by another entity with its own underwriting guidelines and procedures, we elected to account for the Fireside receivables and the related debt secured by those receivables at their estimated fair values so that changes in fair value will be reflected in our results of operations as they occur. We use our own assumptions about the factors that we believe market participants would use in pricing similar receivables and debt, and are based on the best information available in the circumstances. The valuation method used to estimate fair value may produce a fair value measurement that may not be indicative of ultimate realizable value. Furthermore, while we believe our valuation methods are appropriate and consistent with those used by other market participants, the use of different methods or assumptions to estimate the fair value of certain financial instruments could result in different estimates of fair value. Those estimated values may differ significantly from the values that would have been used had a readily available market for such receivables or debt existed, or had such receivables or debt been

liquidated, and those differences could be material to the financial statements. Interest income from the receivables and interest expense on the debt are included in interest income and interest expense, respectively. Changes to the fair value of the receivables and debt are also included in interest income and interest expense, respectively.

#### Charge Off Policy

Delinquent contracts for which the related financed vehicle has been repossessed are generally charged off at the earliest of (1) the month in which the proceeds from the sale of the financed vehicle are received, (2) the month in which 90 days have passed from the date of repossession or (3) the month in which the Contract becomes seven scheduled payments past due (see Repossessed and Other Assets below). The amount charged off is the remaining principal balance of the Contract, after the application of the net proceeds from the liquidation of the financed vehicle. With respect to delinquent contracts for which the related financed vehicle has not been repossessed, the remaining principal balance is generally charged off no later than the end of the month that the Contract becomes five scheduled payments past due.

#### Contract Acquisition Fees and Origination Costs

Upon purchase of a Contract from a Dealer, we generally either charge or advance the Dealer an acquisition fee. Dealer acquisition fees and deferred origination costs are applied to the carrying value of finance receivables and are accreted into earnings as an adjustment to the yield over the estimated life of the Contract using the interest method.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Repossessed and Other Assets

If a Contract obligor fails to make or keep promises for payments, or if the obligor is uncooperative or attempts to evade contact or hide the vehicle, a supervisor will review the collection activity relating to the account to determine if repossession of the vehicle is warranted. Generally, such a decision is made between the 60th and 90th day past the obligor's payment due date, but could occur sooner or later, depending on the specific circumstances. At the time the vehicle is repossessed we stop accruing interest on the Contract, and reclassify the remaining Contract balance to the line item "Other Assets" on our Consolidated Balance Sheet at its estimated fair value less costs to sell. Included in other assets in the accompanying Consolidated Balance Sheets are repossessed vehicles pending sale of \$12.8 million and \$10.4 million at December 31, 2015 and 2014, respectively.

*Treatment of Securitizations*

Our term securitization structure has generally been as follows:

We sell contracts we acquire to a wholly-owned SPS, which has been established for the limited purpose of buying and reselling our contracts. The SPS then transfers the same contracts to another entity, typically a statutory trust ("Trust"). The Trust issues interest-bearing asset-backed securities ("Notes"), in a principal amount equal to or less than the aggregate principal balance of the contracts. We typically sell these contracts to the Trust at face value and without recourse, except representations and warranties that we make to the Trust that are similar to those provided to us by the Dealer. One or more investors (the "Noteholders") purchase the Notes issued by the Trust; the proceeds from the sale of the Notes are then used to purchase the contracts from us. We may retain or sell subordinated Notes issued by the Trust. In addition, we have provided "Credit Enhancement" for the benefit of the Noteholders in three forms: (1) an initial cash deposit to a bank account (a "Spread Account") held by the Trust, (2) overcollateralization of the Notes, where the principal balance of the Notes issued is less than the principal balance of the contracts, and (3) in the form of subordinated Notes. The agreements governing the securitization transactions (collectively referred to as the "Securitization Agreements") require that the initial level of Credit Enhancement be supplemented by a portion of collections from the contracts until the level of Credit Enhancement reaches specified levels, which are then maintained. The specified levels are generally computed as a percentage of the principal amount remaining unpaid under the related contracts. The specified levels at which the Credit Enhancement is to be maintained will vary depending on the performance of the portfolios of contracts held by the Trusts and on other conditions. Such levels have increased and decreased from time to time based on performance of the various portfolios, and have also varied from one Trust to another.

Our warehouse securitization structures are similar to the above, except that (i) the SPS that purchases the contracts pledges the contracts to secure promissory notes or loans that it issues, and (ii) no increase in the required amount of Credit Enhancement is contemplated. Upon each sale of contracts in a securitization structured as a secured financing, we retain as assets on our Consolidated Balance Sheet the securitized contracts and record as indebtedness the Notes issued in the transaction.

We have the power to direct the most significant activities of the SPS. In addition, we have the obligation to absorb losses and the rights to receive benefits from the SPS, both of which could be potentially significant to the SPS. These types of securitization structures are treated as secured financings, in which the receivables remain on our Consolidated Balance Sheet, and the debt issued by the SPS is shown as a securitization trust debt on our Consolidated Balance Sheet.

We receive periodic base servicing fees for the servicing and collection of the contracts. In addition, we are entitled to the cash flows from the Trusts that represent collections on the contracts in excess of the amounts required to pay principal and interest on the Notes, the base servicing fees, and the premium paid to the Note Insurer, if any, and certain other fees (such as trustee and custodial fees). Required principal payments on the Notes are generally defined as the payments sufficient to keep the principal balance of the Notes equal to the aggregate principal balance of the related contracts (excluding those contracts that have been charged off), or a pre-determined percentage of such balance. Where that percentage is less than 100%, the related Securitization Agreements require accelerated payment of principal until the principal balance of the Notes is reduced to the specified percentage. Such accelerated principal payment is said to create "overcollateralization" of the Notes.



CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

If the amount of cash required for payment of fees, interest and principal on the senior Notes exceeds the amount collected during the collection period, the shortfall is generally withdrawn from the Spread Account, if any. If the cash collected during the period exceeds the amount necessary for the above allocations plus required principal payments on the subordinated Notes, if any, and there is no shortfall in the related Spread Account or other form of Credit Enhancement, the excess is released to us. If the total Credit Enhancement amount is not at the required level, then the excess cash collected is retained in the Trust until the specified level is achieved. Cash in the Spread Accounts is restricted from our use. Cash held in the various Spread Accounts is invested in high quality, liquid investment securities, as specified in the Securitization Agreements. In all of our term securitizations we have transferred the receivables (through a subsidiary) to the securitization Trust. We report the assets and liabilities of the securitization Trust on our Consolidated Balance Sheet. The Noteholders' and the related securitization Trusts' recourse against us for failure of the contract obligors to make payments on a timely basis is limited, in general, to our Finance Receivables, and Spread Accounts.

Servicing

We consider the contractual servicing fee received on our managed portfolio held by non-consolidated subsidiaries to be equal to adequate compensation. Additionally, we consider that these fees would fairly compensate a substitute servicer, should one be required. As a result, no servicing asset or liability has been recognized. Servicing fees received on the managed portfolio held by non-consolidated subsidiaries are reported as income when earned. Servicing fees received on the managed portfolio held by consolidated subsidiaries are included in interest income when earned. Servicing costs are charged to expense as incurred. Servicing fees receivable, which are included in Other Assets in the accompanying Consolidated Balance Sheets, represent fees earned but not yet remitted to us by the trustee.

Furniture and Equipment

Furniture and equipment are stated at cost net of accumulated depreciation. We calculate depreciation using the straight-line method over the estimated useful lives of the assets, which range from three to five years. Assets held under capital leases and leasehold improvements are amortized over the lesser of the estimated useful lives of the assets or the related lease terms. Amortization expense on assets acquired under capital lease is included with depreciation expense on owned assets.

## Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

Long-lived assets and certain identifiable intangibles are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

## Other Income

The following table presents the primary components of Other Income:

|  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2015                    | 2014     | 2013     |
|  | (In thousands)          |          |          |
| Direct mail revenues                           | \$8,927                 | \$7,975  | \$7,004  |
| Convenience fee revenue                        | 2,610                   | 3,300    | 2,965    |
| Recoveries on previously charged-off contracts | 1,079                   | 143      | 177      |
| Sales tax refunds                              | 616                     | 500      | 197      |
| Other  | 187                     | 228      | 62       |
|  | \$13,419                | \$12,146 | \$10,405 |

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Earnings Per Share

The following table illustrates the computation of basic and diluted earnings per share:

|   | Year Ended December 31,               |          |          |
|---|---------------------------------------|----------|----------|
|   | 2015                                  | 2014     | 2013     |
|   | (In thousands, except per share data) |          |          |
| Numerator:  |                                       |          |          |
| Numerator for basic and diluted earnings per share  | \$34,681                              | \$29,516 | \$21,005 |
| Denominator:  |                                       |          |          |
| Denominator for basic earnings per share - weighted average number of common shares outstanding during the year | 25,935                                | 25,040   | 21,538   |
| Incremental common shares attributable to exercise of outstanding options and warrants                          | 5,649                                 | 6,992    | 10,036   |
| Denominator for diluted earnings per share  | 31,584                                | 32,032   | 31,574   |
| Basic earnings per share  | \$1.34                                | \$1.18   | \$0.98   |
| Diluted earnings per share  | \$1.10                                | \$0.92   | \$0.67   |

Incremental shares of 6.8 million, 4.5 million and 2.1 million related to stock options and warrants have been excluded from the diluted earnings per share calculation for the years ended December 31, 2015, 2014 and 2013, respectively, because the effect is anti-dilutive.

## Deferral and Amortization of Debt Issuance Costs

Costs related to the issuance of debt are deferred and amortized using the interest method over the contractual or expected term of the related debt.

## Income Taxes

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. We estimate a valuation allowance against that portion of the deferred tax asset whose utilization in future periods is not more than likely.

#### Purchases of Company Stock

We record purchases of our own common stock at cost and treat the shares as retired.

#### Stock Option Plan

We recognize compensation costs in the financial statements for all share-based payments granted subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of ASC 718 "Stock Compensation". Compensation cost is recognized over the required service period, generally defined as the vesting period.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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. Specifically, a number of estimates were made in connection with determining an appropriate allowance for finance credit losses, determining appropriate reserves for contingent liabilities, valuing finance receivables measured at fair value and the related debt, accreting net acquisition fees, amortizing deferred costs, and recording deferred tax assets and reserves for uncertain tax positions. These are material estimates that could be susceptible to changes in the near term and, accordingly, actual results could differ from those estimates.

Reclassification

Certain amounts for the prior year have been reclassified to conform to the current year's presentation with no effect on previously reported earnings or shareholders' equity.

*Financial Covenants*

Certain of our securitization transactions, our residual interest financing 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 securitization and non-securitization related debt contain cross-default provisions that would allow certain creditors to declare a default if a default occurred under a different facility. As of December 31, 2015 we were in compliance with all such financial covenants.

*Gain on Cancellation of Debt*

In April 2013, we repurchased the outstanding Class D notes from our first 2008 securitization for a cash payment of \$6.1 million and a new 5% note for \$5.3 million due in June 2014. The Class D notes were held by the same related party that held our senior secured debt. On the date we repurchased the Class D notes, the Class D note holder owned 10.5% of our outstanding common stock and warrants to purchase an additional 1.9 million shares of common stock. We subsequently exercised our “clean-up call” option and repurchased the remaining collateral from the related securitization trust. The aggregate value of our consideration for the Class D notes was \$10.9 million less than our carrying value of the Class D notes at the time of the repurchase. As a result of the repurchase of the Class D notes and the termination of the securitization trust, we realized a gain of \$10.9 million for the year ended December 31, 2013.

#### *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.

In 2013, we recognized \$7.8 million in contingent liability expenses to either record or increase the amounts we believed represented our best estimate of probable incurred losses related to various matters. The amount was allocated in part to a long running case (“Pardee”) in which we were sued for indemnity, and also to more recent matters. In September 2014 we reached a settlement of the Pardee case, pursuant to which we paid \$5.99 million and all claims against us were fully and finally discharged.

The more recent matters included two California class action suits where we were the defendant, and a governmental inquiry in which the United States Federal Trade Commission (“FTC”) had informally proposed that we refrain from certain allegedly unfair trade practices, and make restitutionary payments into a consumer relief fund. In May 2014, the FTC announced its agreement to settle the matter by filing a lawsuit against us, and requesting, with our consent, that the court enter an agreed judgment against us. The lawsuit arose out of the FTC’s inquiry into our business practices. Under the agreed settlement, we made approximately \$1.9 million of restitutionary payments and \$1.6 million of account adjustments to our customers in September 2014, and paid a \$2 million penalty to the federal government in June 2014, and implemented procedural changes, all pursuant to a consent decree entered by the court in June 2014.

We have recorded a liability as of December 31, 2015, 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.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*Recently Issued Accounting Standards*

In August 2015, the Financial Accounting Standard Board (FASB) issued Accounting Standard Update (ASU) No. 2015-14, Revenue from Contracts with Customers (Topic 606) (ASU 2015-14). In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606), with an original effective date for annual reporting periods beginning after December 15, 2016. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2015-14 deferred the effective date of ASU 2014-09 to annual periods and interim periods within those annual periods beginning after December 15, 2017. The Company is currently evaluating the effects of ASU 2015-14 on its financial statements and disclosures, if any.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities (ASU 2016-01). The main objective of ASU 2016-01 is to enhance the reporting model for financial instruments to provide users of financial statements with more decision-useful information. ASU 2016-01 addresses certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. Some of the amendments in ASU 2016-01 include the following: 1) Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income; 2) Simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment; 3) Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; 4) Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value; among others. The amendments of ASU 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the effects of ASU 2016-01 on its financial statements and disclosures, if any.

In February 2016, the FASB issued a comprehensive new leases standard that amends various aspects of existing accounting guidance for leases. It will require recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The main difference between previous GAAP and the amended standard is the recognition of lease assets and lease liabilities by lessees on the balance sheet for those leases classified as operating leases under previous GAAP. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. As a result, the Company will have to recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. The guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the effects of the new guidance on its financial statements and disclosures.

*(2) Restricted Cash*

Restricted cash consists of cash and cash equivalent accounts relating to our outstanding securitization trusts and credit facilities. The amount of restricted cash on our Consolidated Balance Sheets was \$106.1 million and \$175.4 million as of December 31, 2015 and 2014, respectively.

Our securitization transactions and one of our warehouse credit facilities require that we establish cash reserves, or spread accounts, as additional credit enhancement. These cash reserves, which are included in restricted cash, were \$38.9 million and \$31.2 million as of December 31, 2015 and 2014, respectively.

*(3) 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. 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:

|  | December 31,   |             |
|--|----------------|-------------|
|  | 2015           | 2014        |
|  | (In thousands) |             |
| Finance receivables  |                |             |
| Automobile finance receivables, net of unearned interest                       | \$1,990,913    | \$1,612,246 |
| Less: Unearned acquisition fees, discounts and deferred origination costs, net | (5,820 )       | (16,290 )   |
| Finance receivables  | \$1,985,093    | \$1,595,956 |

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 reported as delinquent. In certain circumstances we will grant obligors one-month payment extensions. 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 December 31, 2015 and 2014:

|                    | December 31,   |             |
|--------------------|----------------|-------------|
|                    | 2015           | 2014        |
|                    | (In thousands) |             |
| Delinquency Status |                |             |
| Current            | \$1,836,267    | \$1,523,020 |
| 31 - 60 days       | 70,036         | 42,730      |
| 61 - 90 days       | 41,136         | 23,300      |
| 91 + days          | 43,474         | 23,196      |
|                    | \$1,990,913    | \$1,612,246 |

Finance receivables totaling \$43.5 million and \$23.2 million at December 31, 2015 and 2014, respectively, have been placed on non-accrual status as a result of their delinquency status.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The following table presents a summary of the activity for the allowance for finance credit losses, for the years ended December 31, 2015, 2014 and 2013:

|                              | December 31,          |           |          |
|------------------------------|-----------------------|-----------|----------|
|                              | 2015                  | 2014      | 2013     |
|                              | <b>(In thousands)</b> |           |          |
| Balance at beginning of year | \$61,460              | \$39,626  | \$19,594 |
| Provision for credit losses  | 142,618               | 108,228   | 76,869   |
| Charge-offs                  | (156,553)             | (109,914) | (69,455) |
| Recoveries                   | 28,078                | 23,520    | 12,618   |
| Balance at end of year       | \$75,603              | \$61,460  | \$39,626 |

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 on repossessed inventory:

|  | December 31,          |          |
|--|-----------------------|----------|
|  | 2015                  | 2014     |
|  | <b>(In thousands)</b> |          |
| Gross balance of repossessions in inventory        | \$39,728              | \$28,234 |
| Allowance for losses on repossessed inventory      | (26,954)              | (17,829) |
| Net repossessed inventory included in other assets | \$12,774              | \$10,405 |

*(4) Furniture and Equipment*

The following table presents the components of furniture and equipment:

|                                  | December 31,          |         |
|----------------------------------|-----------------------|---------|
|                                  | 2015                  | 2014    |
|                                  | <b>(In thousands)</b> |         |
| Furniture and fixtures           | \$1,517               | \$1,396 |
| Computer and telephone equipment | 5,249                 | 4,424   |

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|   |         |         |
|---|---------|---------|
| Leasehold improvements                          | 1,116   | 871     |
|   | 7,882   | 6,691   |
| Less: accumulated depreciation and amortization | (6,167) | (5,530) |
|   | \$1,715 | \$1,161 |

Depreciation expense totaled \$637,000, \$428,000 and \$437,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

F-17

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(5) Securitization Trust Debt*

We have completed numerous term securitization transactions that are structured as secured borrowings for financial accounting purposes. The debt issued in these transactions is shown on our 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 December 31, 2015 (2) | Initial Principal | Outstanding Principal at December 31, 2015 | Outstanding Principal at December 31, 2014 | Weighted Average Interest Rate at December 31, 2015 |
|------------|----------------------------------|--|-------------------|--|--|---|
| CPS 2011-A | April 2018                       | \$–  | \$100,364         | \$–  | \$8,457                                    | –   |
| CPS 2011-B | September 2018                   | 10,469                                       | 109,936           | 10,023                                     | 22,985                                     | 4.40%   |
| CPS 2011-C | March 2019                       | 14,756                                       | 119,400           | 14,785                                     | 30,601                                     | 4.91%   |
| CPS 2012-A | June 2019                        | 18,273                                       | 155,000           | 16,795                                     | 35,923                                     | 3.15%   |
| CPS 2012-B | September 2019                   | 27,463                                       | 141,500           | 26,758                                     | 50,125                                     | 3.07%   |
| CPS 2012-C | December 2019                    | 31,556                                       | 147,000           | 30,653                                     | 55,619                                     | 2.34%   |
| CPS 2012-D | March 2020                       | 38,886                                       | 160,000           | 37,464                                     | 67,833                                     | 1.92%   |
| CPS 2013-A | June 2020                        | 58,082                                       | 185,000           | 56,583                                     | 97,775                                     | 1.85%   |
| CPS 2013-B | September 2020                   | 72,081                                       | 205,000           | 70,332                                     | 118,692                                    | 2.36%   |
| CPS 2013-C | December 2020                    | 83,811                                       | 205,000           | 82,851                                     | 133,628                                    | 3.43%   |
| CPS 2013-D | March 2021                       | 83,263                                       | 183,000           | 82,337                                     | 132,150                                    | 2.99%   |
| CPS 2014-A | June 2021                        | 93,776                                       | 180,000           | 92,571                                     | 143,456                                    | 2.51%   |
| CPS 2014-B | September 2021                   | 121,772                                      | 202,500           | 121,515                                    | 177,601                                    | 2.21%   |
| CPS 2014-C | December 2021                    | 184,739                                      | 273,000           | 183,802                                    | 256,151                                    | 2.41%   |
| CPS 2014-D | March 2022                       | 200,611                                      | 267,500           | 198,533                                    | 267,500                                    | 2.63%   |
| CPS 2015-A | June 2022                        | 203,819                                      | 245,000           | 201,527                                    | –  | 2.48%   |
| CPS 2015-B | September 2022                   | 226,054                                      | 250,000           | 221,587                                    | –  | 2.57%   |
| CPS 2015-C | December 2022                    | 287,685                                      | 300,000           | 283,482                                    | –  | 2.96%   |
|            |                                  | \$1,757,096                                  | \$3,429,200       | \$1,731,598                                | \$1,598,496                                |   |

*(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 \$669.2 million in 2016, \$506.5 million in 2017, \$315.4 million in 2018, \$172.2 million in 2019, \$64.3 million in 2020, and \$4.0 million in 2021.*

*(2)Includes repossessed assets that are included in Other Assets on our Consolidated Balance Sheets.*

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

The terms of the various securitization agreements related to the issuance of the securitization trust debt require that certain delinquency and credit loss criteria be met with respect to the collateral pool, and require that we maintain minimum levels of liquidity and net worth and not exceed maximum leverage levels. We were in compliance with all such covenants as of December 31, 2015.

We are responsible for the administration and collection of the contracts. The securitization agreements also require certain funds be held in restricted cash accounts to provide additional credit enhancement for the Notes or to be applied to make payments on the securitization trust debt. As of December 31, 2015, restricted cash under the various agreements totaled approximately \$106.1 million. Interest expense on the securitization trust debt is composed of the stated rate of interest plus amortization of additional costs of borrowing. Additional costs of borrowing include facility fees, insurance premiums, amortization of deferred financing costs, and amortization of discounts required on the notes at the time of issuance. Deferred financing costs related to the securitization trust debt are amortized using the interest method. Accordingly, the effective cost of borrowing of the securitization trust debt is greater than the stated rate of interest.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 warehouse line of credit. 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 any of our other creditors.

*(6) Debt*

The terms of our debt outstanding at December 31, 2015 and 2014 are summarized below:

| Description               | Interest Rate                                    | Maturity      | Amount Outstanding            |                         |
|---------------------------|--|---------------|-------------------------------|-------------------------|
|                           |  |               | at<br>December<br>31,<br>2015 | December<br>31,<br>2014 |
|                           |  |               | (In thousands)                |                         |
| Warehouse lines of credit | 5.50% over one month<br>Libor<br>(Minimum 6.50%) | April 2019    | \$91,504                      | \$ 23,581               |
|                           | 5.50% over one month<br>Libor<br>(Minimum 6.25%) | August 2017   | 73,940                        | 33,258                  |
|                           | 6.75% over one month<br>Libor<br>(Minimum 7.75%) | November 2019 | 31,017                        | —                       |
|                           |  | April 2018    | 9,042                         | 12,327                  |

|  |  |  |           |           |
|--|--|--|-----------|-----------|
| Residual interest financing                        | 11.75% over one month<br>Libor   |  |           |           |
| Debt secured by receivables measured at fair value | n/a  | Repayment is based on payments from underlying receivables. Final payment of the 8.00% loan was made in September 2013. Final residual payment was made in January 2015. | –         | 1,250     |
| Subordinated renewable notes                       | Weighted average rate of 9.04% and 10.7% at December 31, 2015 and 2014, respectively | Weighted average maturity of October 2017 and October 2016 at December 31, 2015 and 2014, respectively   | 15,138    | 15,233    |
|  |  |  | \$220,641 | \$ 85,649 |

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In April 2015 we entered into a \$100 million warehouse credit line with affiliates of Fortress Investment Group. The facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Six Funding LLC. The facility, which replaces a revolving credit facility that we had used since December 2010, provides for advances up to 88% of eligible finance receivables and the loans under it accrue interest at a rate of one-month LIBOR plus 5.50% per annum, with a minimum rate of 6.50% per annum. There was \$91.5 million outstanding under this new facility at December 31, 2015 which has a revolving period through April 2017 and an amortization period through April 2019 for any receivables pledged to the facility at the end of the revolving period.

In August 2014, we renewed our \$100 million warehouse credit line with Citibank, N.A. The facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Eight Funding, LLC. The facility provides for effective advances up to 88.0% of eligible finance receivables. The loans under the facility accrue interest at one-month LIBOR plus 5.50% per annum, with a minimum rate of 6.25% per annum. There was \$73.9 million outstanding under this facility at December 31, 2015. This facility has a revolving period through August 2016 and an amortization period through August 2017 for any receivables pledged at the end of the revolving period.

In November 2015, we entered into another \$100 million warehouse credit line with Credit Suisse AG and Ares Agent Services, L.P. This facility is structured to allow us to fund a portion of the purchase price of automobile contracts by borrowing from a credit facility to our consolidated subsidiary Page Nine Funding LLC. The facility provides for advances up to 88% of eligible finance receivables and the loans under it accrue interest at a commercial paper rate plus 6.75% per annum, with a minimum rate of 7.75% per annum. There was \$31.0 million outstanding under this new facility at December 31, 2015 which has a revolving period through November 2017 and an amortization period through November 2019 for any receivables pledged to the facility at the end of the revolving period.

The total outstanding debt on our three warehouse lines of credit was \$196.5 million as of December 31, 2015, compared to \$56.8 million outstanding as of December 31, 2014.

The costs incurred in conjunction with the above debt are recorded as deferred financing costs on the accompanying Consolidated Balance Sheets and are more fully described in Note 1.



We must comply with certain affirmative and negative covenants related to debt facilities, which require, among other things, that we maintain certain financial ratios related to liquidity, net worth and capitalization. Further covenants include matters relating to investments, acquisitions, restricted payments and certain dividend restrictions. See the discussion of financial covenants in Note 1.

The following table summarizes the contractual and expected maturity amounts of long term debt as of December 31, 2015:

| Contractual maturity date | Residual interest financing (1)<br>(In thousands) | Subordinated renewable notes | Total    |
|---------------------------|---|------------------------------|----------|
| 2016                      | \$2,400   | \$ 9,910                     | \$12,310 |
| 2017                      | 3,900   | 1,781                        | 5,681    |
| 2018                      | 2,742   | 1,110                        | 3,852    |
| 2019                      | –   | 276                          | 276      |
| 2020                      | –   | 342                          | 342      |
| Thereafter                | –   | 1,719                        | 1,719    |
| Total                     | \$9,042   | \$ 15,138                    | \$24,180 |

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(1) *The residual interest financing debt has a contractual maturity date in April 2018. This debt may become due and payable prior to that date, based on the decreasing valuation of the underlying collateral.*

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### (7) Shareholders' Equity

##### Common Stock

Holders of common stock are entitled to such dividends as our board of directors, in its discretion, may declare out of funds available, subject to the terms of any outstanding shares of preferred stock and other restrictions. In the event of liquidation of the Company, holders of common stock are entitled to receive, *pro rata*, all of the assets of the Company available for distribution, after payment of any liquidation preference to the holders of outstanding shares of preferred stock. Holders of the shares of common stock have no conversion or preemptive or other subscription rights and there are no redemption or sinking fund provisions applicable to the common stock.

We are required to comply with various operating and financial covenants defined in the agreements governing the warehouse lines of credit, senior debt, residual interest financing and subordinated debt. The covenants for the senior debt, residual interest financing and subordinated debt restrict the payment of certain distributions, including dividends (See Note 6).

##### Stock Purchases

In April and again in October 2015 our board of directors authorized the repurchase of up to \$5 million of our common stock for a total of \$10 million. Prior to April, there was \$1.0 million of board authorization remaining in our repurchase plans from prior authorizations. For the year ending December 31, 2015, we purchased \$5.9 million of our common stock, representing 1,063,869 shares. There is approximately \$5.1 million of board authorization remaining under such plans, which have no expiration date.

##### Options and Warrants

In 2006, the Company adopted and its shareholders approved the CPS 2006 Long-Term Equity Incentive Plan (the "2006 Plan") pursuant to which our Board of Directors, or a duly-authorized committee thereof, may grant stock options, restricted stock, restricted stock units and stock appreciation rights to our employees or employees of our subsidiaries, to directors of the Company, and to individuals acting as consultants to the Company or its subsidiaries.

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In June 2008, May 2012, April 2013 and again in May 2015, the shareholders of the Company approved an amendment to the 2006 Plan to increase the maximum number of shares that may be subject to awards under the 2006 Plan to 5,000,000, 7,200,000, 12,200,000 and 17,200,000, respectively, in each case plus shares authorized under prior plans and not issued. Options that have been granted under the 2006 Plan and a previous plan approved in 1997 have been granted at an exercise price equal to (or greater than) the stock's fair value at the date of the grant, with terms generally of 7-10 years and vesting generally over 4-5 years.

The per share weighted-average fair value of stock options granted during the years ended December 31, 2015, 2014 and 2013 was \$2.41, \$2.73 and \$4.79, respectively. That fair value was estimated using a binomial option pricing model using the weighted average assumptions noted in the following table. We use historical data to estimate the expected term of each option. The volatility estimate is based on the historical and implied volatility of our stock over the period that equals the expected life of the option. Volatility assumptions ranged from 47% to 51% for 2015, 52% to 55% for 2014 and 50% to 85% for 2013. The risk-free interest rate is based on the yield on a U.S. Treasury bond with a maturity comparable to the expected life of the option. The dividend yield is estimated to be zero based on our intention not to issue dividends for the foreseeable future.

|                         | Year Ended December |       |       |
|-------------------------|---------------------|-------|-------|
|                         | 2015                | 2014  | 2013  |
| Expected life (years)   | 4.21                | 4.22  | 5.41  |
| Risk-free interest rate | 1.35%               | 1.43% | 0.73% |
| Volatility              | 51%                 | 55%   | 80%   |
| Expected dividend yield | –                   | –     | –     |

For the years ended December 31, 2015, 2014 and 2013, we recorded stock-based compensation costs in the amount of \$5.0 million, \$3.8 million and \$3.9 million, respectively. As of December 31, 2015, the unrecognized stock-based compensation costs to be recognized over future periods was equal to \$13.3 million. This amount will be recognized as expense over a weighted-average period of 2.6 years.

At December 31, 2015 and 2014, options outstanding had intrinsic values of \$16.6 million and \$36.7 million, respectively. At December 31, 2015 and 2014, options exercisable had intrinsic values of \$14.5 million and \$28.1 million, respectively. The total intrinsic value of options exercised was \$6.4 million and \$9.1 million for the years ended December 31, 2015 and 2014, respectively. New shares were issued for all options exercised during the year ended December 2015 and cash of \$1.7 million was received. A tax benefit of \$634,000 was recorded for the options exercised in 2015. At December 31, 2015, there were a total of 5.5 million additional shares available for grant under the 2006 Plan.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Stock option activity for the year ended December 31, 2015 for stock options under the 2006 and 1997 plans is as follows:

|  | Number of<br>Shares<br>(in<br>thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted Average Remaining<br>Contractual<br>Term |
|--|--|--|---|
| Options outstanding at the beginning of period | 10,828                                   | \$ 4.05                                  | N/A   |
| Granted  | 1,965                                    | 6.11                                     | N/A   |
| Exercised                                      | (1,233 )                                 | 1.39                                     | N/A   |
| Forfeited/Expired                              | (332 )                                   | 5.43                                     | N/A   |
| Options outstanding at the end of period       | 11,228                                   | \$ 4.66                                  | 5.55 years  |
| Options exercisable at the end of period       | 6,132                                    | \$ 3.49                                  | 4.87 years  |

We did not issue any stock options with an exercise price above or below the market price of the stock on the grant date for the years ended December 31, 2015, 2014 and 2013.

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 December 31, 2015.

*(8) Interest Income and Interest Expense*

The following table presents the components of interest income:

|                                 | Year Ended December 31, |           |           |
|---------------------------------|-------------------------|-----------|-----------|
|                                 | 2015                    | 2014      | 2013      |
|                                 | (In thousands)          |           |           |
| Interest on finance receivables | \$349,796               | \$286,361 | \$231,320 |
| Residual interest income        | 92                      | 372       | –         |
| Other interest income           | 24                      | 1         | 10        |
| Interest income                 | \$349,912               | \$286,734 | \$231,330 |

The following table presents the components of interest expense:

|   | Year Ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2015                    | 2014     | 2013     |
|   | (In thousands)          |          |          |
| Securitization trust debt                 | \$48,631                | \$38,558 | \$34,744 |
| Warehouse lines of credit                 | 6,127                   | 5,217    | 5,003    |
| Senior secured debt, related party        | –                       | 1,651    | 8,064    |
| Debt secured by receivables at fair value | –                       | 772      | 3,877    |
| Residual interest financing               | 1,405                   | 1,989    | 3,330    |
| Subordinated renewable notes              | 1,582                   | 2,208    | 3,161    |
| Interest expense                          | \$57,745                | \$50,395 | \$58,179 |

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(9) Income Taxes*

Income taxes consist of the following:

|                              | Year Ended December 31, |          |          |
|------------------------------|-------------------------|----------|----------|
|                              | 2015                    | 2014     | 2013     |
|                              | (In thousands)          |          |          |
| Current federal tax expense  | \$18,653                | \$1,348  | \$977    |
| Current state tax expense    | 1,146                   | 1,316    | 365      |
| Deferred federal tax expense | 4,233                   | 18,338   | 13,306   |
| Deferred state tax expense   | 2,669                   | 1,724    | 1,520    |
| Income tax expense           | \$26,701                | \$22,726 | \$16,168 |

Income tax expense for the years ended December 31, 2015, 2014 and 2013 differs from the amount determined by applying the statutory federal rate of 35% to income before income taxes as follows:

|   | Year Ended December 31, |          |          |
|---|-------------------------|----------|----------|
|   | 2015                    | 2014     | 2013     |
|   | (In thousands)          |          |          |
| Expense at federal tax rate                   | \$21,484                | \$18,285 | \$13,011 |
| State taxes, net of federal income tax effect | 3,235                   | 2,651    | 2,079    |
| Stock-based compensation                      | 1,560                   | 1,182    | 911      |
| Non-deductible expenses                       | 107                     | 116      | 619      |
| Other   | 315                     | 492      | (452 )   |
|   | \$26,701                | \$22,726 | \$16,168 |

The tax effected cumulative temporary differences that give rise to deferred tax assets and liabilities as of December 31, 2015 and 2014 are as follows:

December 31,  
2015      **2014**  
(In thousands)

Deferred Tax Assets:

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|                           |          |          |
|---------------------------|----------|----------|
| Finance receivables       | \$20,825 | \$19,046 |
| Accrued liabilities       | 3,091    | 2,551    |
| Furniture and equipment   | –        | 16       |
| NOL carryforwards         | 3,272    | 6,922    |
| Built in losses           | 10,254   | 11,698   |
| Pension accrual           | 1,999    | 1,090    |
| AMT credit carryforward   | 166      | 2,899    |
| Other                     | 1,109    | 941      |
| Total deferred tax assets | 40,716   | 45,163   |

Deferred Tax Liabilities:

|                                |          |          |
|--------------------------------|----------|----------|
| Deferred loan costs            | (2,894 ) | (2,316 ) |
| Furniture and equipment        | (225 )   | –        |
| Total deferred tax liabilities | (3,119)  | (2,316 ) |

|                        |          |          |
|------------------------|----------|----------|
| Net deferred tax asset | \$37,597 | \$42,847 |
|------------------------|----------|----------|

We acquired certain net operating losses and built-in loss assets as part of our acquisitions of MFN Financial Corp. (“MFN”) in 2002 and TFC Enterprises, Inc. (“TFC”) in 2003. Moreover, both MFN and TFC have undergone an ownership change for purposes of Internal Revenue Code (“IRC”) Section 382. In general, IRC Section 382 imposes an annual limitation on the ability of a loss corporation (that is, a corporation with a net operating loss (“NOL”) carryforward, credit carryforward, or certain built-in losses (“BILs”)) to utilize its pre-change NOL carryforwards or BILs to offset taxable income arising after an ownership change.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

In determining the possible future realization of deferred tax assets, we have considered future taxable income from the following sources: (a) reversal of taxable temporary differences; and (b) tax planning strategies that, if necessary, would be implemented to accelerate taxable income into years in which net operating losses might otherwise expire.

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 \$37.6 million as of December 31, 2015 is more likely than not based on forecasted future net earnings. Our net deferred tax asset of \$37.6 million consists of approximately \$29.9 million of net U.S. federal deferred tax assets and \$7.7 million of net state deferred tax assets. The major components of the deferred tax asset are \$13.5 million in net operating loss carryforwards and built in losses and \$24.1 million in net deductions which have not yet been taken on a tax return.

As of December 31, 2015, we had net operating loss carryforwards for state income tax purposes of \$67.3 million. These state net operating losses begin to expire in 2016.

We recognize a tax position as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. We recognize potential interest and penalties related to unrecognized tax benefits as income tax expense. At December 31, 2015, we had no unrecognized tax benefits for uncertain tax positions.

We are subject to taxation in the US and various state jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state, or local examinations by tax authorities for years before 2012.

*(10) Related Party Transactions*



In December 2007, one of our directors purchased a \$4.0 million subordinated renewable note pursuant to our ongoing program of issuing such notes to the public. The note was purchased through the registered agent and under the same terms and conditions, including the interest rate, that were offered to other purchasers at the time the note was issued. As of December 31, 2015, \$4.0 million remains outstanding on this note.

*(11) Commitments and Contingencies*

Leases

The Company leases its facilities and certain computer equipment under non-cancelable operating leases, which expire through 2022. Future minimum lease payments at December 31, 2015, under these leases are due during the years ended December 31 as follows:

|                              | <b>Amount<br/>(In thousands)</b> |
|------------------------------|----------------------------------|
| 2016                         | \$4,713                          |
| 2017                         | 5,896                            |
| 2018                         | 5,632                            |
| 2019                         | 5,189                            |
| 2020                         | 4,224                            |
| Thereafter                   | 7,687                            |
| Total minimum lease payments | \$33,341                         |

Rent expense for the years ended December 31, 2015, 2014 and 2013, was \$4.1 million, \$3.5 million and \$2.6 million, respectively.

Our facility leases contain certain rental concessions and escalating rental payments, which are recognized as adjustments to rental expense and are amortized on a straight-line basis over the terms of the leases.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 has appealed that approval.)

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 December 31, 2015 with respect to such matters, in the aggregate.

*FTC Action.* In May 2014, we consented to the FTC's filing of a lawsuit against us, and to the simultaneous settlement of that lawsuit pursuant to a consent decree. The agreed judgment, entered June 11, 2014, required that we make restitutionary payments to certain of our customers, that we pay a \$2 million penalty to the U.S. government, and that we implement procedural changes relating to compliance with fair debt collection practices and credit reporting. We have retained an independent third party to monitor our compliance with the judgment, and we must file certain periodic reports with the FTC. The payments to past and present customers have been completed and paid, partially in cash and partially in the form of credits against amounts owed. The total of such customer payments, cash and credit, was approximately \$3.5 million.

*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 requested 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 the required documents in March 2015, and are unaware of any subsequent material developments in the government's investigation. 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 December 31, 2015, 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 December 31, 2015, and in excess of the liability we have recorded, is from \$0 to \$250,000.

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.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(12) Employee Benefits*

We sponsor a pretax savings and profit sharing plan (the “401(k) Plan”) qualified under Section 401(k) of the Internal Revenue Code. Under the 401(k) Plan, eligible employees are able to contribute up to 15% of their compensation (subject to stricter limitation in the case of highly compensated employees). We may, at our discretion, match 100% of employees’ contributions up to \$1,500 per employee per calendar year. Our contributions to the 401(k) Plan were \$838,000, \$642,000 and \$471,000, respectively, for the year ended December 31, 2015, 2014 and 2013.

We also sponsor a defined benefit plan, the MFN Financial Corporation Pension Plan (the “Plan”). The Plan benefits were frozen on June 30, 2001.

The following tables represents a reconciliation of the change in the plan’s benefit obligations, fair value of plan assets, and funded status at December 31, 2015 and 2014:

|   | December 31,   |          |
|---|----------------|----------|
|   | 2015           | 2014     |
|   | (In thousands) |          |
| Change in Projected Benefit Obligation          |                |          |
| Projected benefit obligation, beginning of year | \$22,559       | \$18,841 |
| Service cost                                    | –              | –        |
| Interest cost                                   | 843            | 888      |
| Assumption changes                              | (485 )         | 3,570    |
| Actuarial (gain) loss                           | (14 )          | 211      |
| Settlements                                     | –              | –        |
| Benefits paid                                   | (1,518 )       | (951 )   |
| Projected benefit obligation, end of year       | \$21,385       | \$22,559 |
| Change in Plan Assets                           |                |          |
| Fair value of plan assets, beginning of year    | \$19,848       | \$21,664 |
| Return on assets                                | (1,818 )       | (1,009 ) |
| Employer contribution                           | –              | 237      |
| Expenses  | (138 )         | (93 )    |
| Settlements                                     | –              | –        |
| Benefits paid                                   | (1,518 )       | (951 )   |

|  |           |           |
|--|-----------|-----------|
| Fair value of plan assets, end of year | \$16,374  | \$19,848  |
| Funded Status at end of year           | \$(5,011) | \$(2,711) |

***Additional Information***

Weighted average assumptions used to determine benefit obligations and cost at December 31, 2015 and 2014 were as follows:

|  | December, 31 |       |
|--|--------------|-------|
|  | 2015         | 2014  |
| Weighted average assumptions used to determine benefit obligations       |              |       |
| Discount rate  | 4.20%        | 3.80% |
| Weighted average assumptions used to determine net periodic benefit cost |              |       |
| Discount rate  | 3.80%        | 4.75% |
| Expected return on plan assets   | 7.75%        | 8.00% |

Our overall expected long-term rate of return on assets is 7.75% per annum as of December 31, 2015. The expected long-term rate of return is based on the weighted average of historical returns on individual asset categories, which are described in more detail below.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

|   | December 31,   |           |           |
|---|----------------|-----------|-----------|
|   | 2015           | 2014      | 2013      |
|   | (In thousands) |           |           |
| Amounts recognized on Consolidated Balance Sheet                        |                |           |           |
| Other assets  | \$—            | \$—       | \$2,823   |
| Other liabilities   | (5,011)        | (2,711)   | —         |
| Net amount recognized   | \$(5,011)      | \$(2,711) | \$2,823   |
| Amounts recognized in accumulated other comprehensive loss consists of: |                |           |           |
| Net loss  | \$10,592       | \$7,977   | \$1,367   |
| Unrecognized transition asset   | —              | —         | —         |
| Net amount recognized   | \$10,592       | \$7,977   | \$1,367   |
| Components of net periodic benefit cost                                 |                |           |           |
| Interest cost   | \$843          | \$888     | \$823     |
| Expected return on assets   | (1,508)        | (1,727)   | (1,335)   |
| Amortization of transition asset  | —              | —         | —         |
| Amortization of net loss  | 349            | —         | 484       |
| Net periodic benefit cost   | (316)          | (839)     | (28)      |
| Settlement (gain)/loss  | —              | —         | —         |
| Total   | \$(316)        | \$(839)   | \$(28)    |
| Benefit Obligation Recognized in Other Comprehensive Loss (Income)      |                |           |           |
| Net loss (gain)   | \$2,615        | \$6,610   | \$(7,586) |
| Prior service cost (credit)   | —              | —         | —         |
| Amortization of prior service cost                                      | —              | —         | —         |
| Net amount recognized in other comprehensive loss (income)              | \$2,615        | \$6,610   | \$(7,586) |

The estimated net loss that will be amortized from accumulated other comprehensive income into net periodic benefit cost in 2016 is \$553,000.

The weighted average asset allocation of our pension benefits at December 31, 2015 and 2014 were as follows:

|   | December 31, |      |
|---|--------------|------|
|   | 2015         | 2014 |
| Weighted Average Asset Allocation at Year-End |              |      |

|                           |      |      |
|---------------------------|------|------|
| Asset Category            |      |      |
| Equity securities         | 84%  | 84%  |
| Debt securities           | 16%  | 15%  |
| Cash and cash equivalents | 0%   | 1%   |
| Total                     | 100% | 100% |

Our investment policies and strategies for the pension benefits plan utilize a target allocation of 75% equity securities and 25% fixed income securities (excluding Company stock). Our investment goals are to maximize returns subject to specific risk management policies. We address risk management and diversification by the use of a professional investment advisor and several sub-advisors which invest in domestic and international equity securities and domestic fixed income securities. Each sub-advisor focuses its investments within a specific sector of the equity or fixed income market. For the sub-advisors focused on the equity markets, the sectors are differentiated by the market capitalization, the relative valuation and the location of the underlying issuer. For the sub-advisors focused on the fixed income markets, the sectors are differentiated by the credit quality and the maturity of the underlying fixed income investment. The investments made by the sub-advisors are readily marketable and can be sold to fund benefit payment obligations as they become payable.

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## Cash Flows

## Estimated Future Benefit Payments (In thousands)

|                   |       |
|-------------------|-------|
| 2016              | \$766 |
| 2017              | 804   |
| 2018              | 840   |
| 2019              | 884   |
| 2020              | 930   |
| Years 2021 - 2025 | 5,289 |

Anticipated Contributions in 2016 \$-

The fair value of plan assets at December 31, 2015 and 2014, by asset category, is as follows:

| Investment Name:         | December 31, 2015 |             |             | Total    |
|--------------------------|-------------------|-------------|-------------|----------|
|                          | Level 1 (1)       | Level 2 (2) | Level 3 (3) |          |
| Company Common Stock     | \$4,643           | \$-         | \$-         | \$4,643  |
| Large Cap Value          | -                 | 2,061       | -           | 2,061    |
| Mid Cap Index            | -                 | 578         | -           | 578      |
| Small Cap Growth         | -                 | 552         | -           | 552      |
| Small Cap Value          | -                 | 573         | -           | 573      |
| Focus Value              | -                 | 571         | -           | 571      |
| Growth                   | -                 | 2,215       | -           | 2,215    |
| International Growth     | -                 | 2,475       | -           | 2,475    |
| Core Bond                | -                 | 1,833       | -           | 1,833    |
| High Yield               | -                 | 354         | -           | 354      |
| Inflation Protected Bond | -                 | 482         | -           | 482      |
| Money Market             | -                 | 37          | -           | 37       |
| Total                    | \$4,643           | \$11,731    | \$-         | \$16,374 |

| Investment Name: | December 31, 2014 |             |             | Total |
|------------------|-------------------|-------------|-------------|-------|
|                  | Level 1 (1)       | Level 2 (2) | Level 3 (3) |       |
| (in thousands)   |                   |             |             |       |



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|                          |         |          |    |       |          |
|--------------------------|---------|----------|----|-------|----------|
| Company Common Stock     | \$6,542 | \$-      | \$ | -     | \$6,542  |
| Large Cap Value          | -       | 2,378    | -  | 2,378 |          |
| Mid Cap Index            | -       | 682      | -  | 682   |          |
| Small Cap Growth         | -       | 691      | -  | 691   |          |
| Small Cap Value          | -       | 673      | -  | 673   |          |
| Focus Value              | -       | 700      | -  | 700   |          |
| Growth                   | -       | 2,383    | -  | 2,383 |          |
| International Growth     | -       | 2,649    | -  | 2,649 |          |
| Core Bond                | -       | 1,969    | -  | 1,969 |          |
| High Yield               | -       | 382      | -  | 382   |          |
| Inflation Protected Bond | -       | 518      | -  | 518   |          |
| Money Market             | -       | 281      | -  | 281   |          |
| Total                    | \$6,542 | \$13,306 | \$ | -     | \$19,848 |

- 
- (1) *Company common stock is classified as level 1 and valued using quoted prices in active markets for identical assets.*
- (2) *All other plan assets in stock, bond and money market funds are classified as level 2 and valued using significant observable inputs.*
- (3) *There are no plan assets classified as level 3 in the fair value hierarchy as a result of having significant unobservable inputs.*

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(13) 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 are 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.

In September 2011, we acquired \$217.8 million of finance receivables from Fireside Bank for a purchase price of \$199.6 million. The receivables were acquired by our wholly-owned special purpose subsidiary, CPS Fender Receivables, LLC, which issued a note for \$197.3 million, with a fair value of \$196.5 million. Since the Fireside receivables were originated by another entity with its own underwriting guidelines and procedures, we have elected to account for the Fireside receivables and the related debt secured by those receivables at their estimated fair values so that changes in fair value will be reflected in our results of operations as they occur. Interest income from the receivables and interest expense on the note are included in interest income and interest expense, respectively. Changes to the fair value of the receivables and debt are included in other income. Our level 3, unobservable inputs reflect our own assumptions about the factors that market participants use in pricing similar receivables and debt, and are based on the best information available in the circumstances. They include such inputs as estimated net charge-offs and timing of the amortization of the portfolio of finance receivables. Our estimate of the fair value of the Fireside receivables is performed on a pool basis, rather than separately on each individual receivable.

The table below presents a reconciliation of the acquired finance receivables and related debt measured at fair value on a recurring basis using significant unobservable inputs:

December 31,

2015      2014  
(in thousands)

Finance Receivables Measured at Fair Value:

|  |          |           |
|--|----------|-----------|
| Balance at beginning of year                     | \$ 1,664 | \$ 14,476 |
| Payments on finance receivables at fair value    | (1,603)  | (12,276)  |
| Charge-offs on finance receivables at fair value | –        | (846 )    |
| Discount accretion                               | –        | 283       |
| Mark to fair value                               | –        | 27        |
| Balance at end of year                           | \$ 61    | \$ 1,664  |

Debt Secured by Finance Receivables Measured at Fair Value:

|  |          |           |
|--|----------|-----------|
| Balance at beginning of year                 | \$ 1,250 | \$ 13,117 |
| Principal payments on debt at fair value     | (1,250)  | (12,456)  |
| Premium accretion                            | –        | 712       |
| Mark to fair value                           | –        | (123 )    |
| Balance at end of year                       | –        | 1,250     |
| Reduction for payments collected and payable | –        | –         |
| Adjusted balance at end of year              | \$–      | \$ 1,250  |

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The table below compares the fair values of the Fireside receivables and the related secured debt to their contractual balances for the periods shown:

|  | December 31, 2015   |            | December 31, 2014   |            |
|--|---------------------|------------|---------------------|------------|
|  | Contractual Balance | Fair Value | Contractual Balance | Fair Value |
|  | (In thousands)      |            |                     |            |
| Fireside receivables portfolio                 | \$61                | \$ 61      | \$1,664             | \$1,664    |
| Debt secured by Fireside receivables portfolio | –                   | –          | –                   | 1,250      |

The fair value of the debt secured by the Fireside receivables portfolio represents the discounted value of future cash flows that we estimate will become due to the lender in accordance with the terms of our financing for the Fireside portfolio. The terms of the debt provide for the lenders to receive a share of residual cash flows from the underlying receivables after the contractual balance of the debt is repaid and the Company's investment in the Fireside portfolio is returned. The final residual payment was made in January 2015.

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 December 31, 2015, the finance receivables related to the repossessed vehicles in inventory totaled \$39.7 million. We have applied a valuation adjustment, or loss allowance, of \$26.9 million, which is based on a recovery rate of approximately 32%, resulting in an estimated fair value and carrying amount of \$12.8 million. The fair value and carrying amount of the repossessed inventory at December 31, 2014 was \$10.4 million after applying a valuation adjustment of \$17.8 million.

There were no transfers in or out of level 1 or level 2 assets and liabilities for 2015 and 2014. We have no level 3 assets that are measured at fair value on a non-recurring basis.

The following table provides certain qualitative information about our level 3 fair value measurements for assets and liabilities carried at fair value:

| <b><u>Financial Instrument</u></b>                 | <b>Fair Values<br/>as of<br/>December<br/>31,</b> |             | <b>Valuation<br/>Techniques</b> | <b>Unobservable Inputs</b>  | <b>Inputs as of<br/>December<br/>31,</b> |             |
|--|---|-------------|---------------------------------|-----------------------------|--|-------------|
|  | <b>2015</b>                                       | <b>2014</b> |                                 |                             | <b>2015</b>                              | <b>2014</b> |
|  | <b>(In<br/>thousands)</b>                         |             |                                 |                             |  |             |
| <b>Assets:</b>                                     |   |             |                                 |                             |  |             |
| Finance receivables measured at fair value         | \$61  | \$1,664     | Discounted cash flows           | Discount rate               | 15.4%                                    | 15.4%       |
|  |   |             |                                 | Cumulative net losses       | 5.0%                                     | 5.0%        |
|  |   |             |                                 | Monthly average prepayments | 0.5%                                     | 0.5%        |
| <b>Liabilities:</b>                                |   |             |                                 |                             |  |             |
| Debt secured by receivables measured at fair value | –   | 1,250       | Discounted cash flows           | Discount rate               | n/a                                      | 12.2%       |

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The estimated fair values of financial assets and liabilities at December 31, 2015 and 2014, were as follows:

| <u>Financial Instrument</u>                | As of December 31, 2015<br>(In thousands) |                                   |            |           |           |
|--|---|-----------------------------------|------------|-----------|-----------|
|  | Carrying<br>Value                         | Fair Value Measurements<br>Using: |            |           | Total     |
|  |   | Level 1                           | Level<br>2 | Level 3   |           |
| Assets:                                    |   |                                   |            |           |           |
| 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    |
| Liabilities:                               |   |                                   |            |           |           |
| Warehouse lines of credit                  | \$196,461                                 | \$–                               | \$ –       | \$196,461 | \$196,461 |
| Accrued interest payable                   | 3,260                                     | –                                 | –          | 3,260     | 3,260     |
| Residual interest financing                | 9,042                                     | –                                 | –          | 9,042     | 9,042     |
| Securitization trust debt                  | 1,731,598                                 | –                                 | –          | 1,718,418 | 1,718,418 |
| Subordinated renewable notes               | 15,138                                    | –                                 | –          | 15,138    | 15,138    |

| <u>Financial Instrument</u>                | As of December 31, 2014<br>(In thousands) |                                   |            |           |           |
|--|---|-----------------------------------|------------|-----------|-----------|
|  | Carrying<br>Value                         | Fair Value Measurements<br>Using: |            |           | Total     |
|  |   | Level 1                           | Level<br>2 | Level 3   |           |
| Assets:                                    |   |                                   |            |           |           |
| Cash and cash equivalents                  | \$17,859                                  | \$17,859                          | \$ –       | \$–       | \$17,859  |
| Restricted cash and equivalents            | 175,382                                   | 175,382                           | –          | –         | 175,382   |
| Finance receivables, net                   | 1,534,496                                 | –                                 | –          | 1,512,567 | 1,512,567 |
| Finance receivables measured at fair value | 1,664                                     | –                                 | –          | 1,664     | 1,664     |
| Accrued interest receivable                | 23,372                                    | –                                 | –          | 23,372    | 23,372    |
| Liabilities:                               |   |                                   |            |           |           |
| Warehouse lines of credit                  | \$56,839                                  | \$–                               | \$ –       | \$56,839  | \$56,839  |
| Accrued interest payable                   | 2,613                                     | –                                 | –          | 2,613     | 2,613     |
| Residual interest financing                | 12,327                                    | –                                 | –          | 12,327    | 12,327    |

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|   |           |   |   |           |           |
|---|-----------|---|---|-----------|-----------|
| Debt secured by receivables measured at<br>fair value | 1,250     | – | – | 1,250     | 1,250     |
| Securitization trust debt                             | 1,598,496 | – | – | 1,619,742 | 1,619,742 |
| Subordinated renewable notes                          | 15,233    | – | – | 15,233    | 15,233    |

F-31

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 December 31, 2015 and 2014, 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 and Debt Secured by 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.

F-32

## CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(14) Quarterly Financial Data (unaudited)*

|                                  | Quarter Ended                         |          |                  |                 |
|----------------------------------|---------------------------------------|----------|------------------|-----------------|
|                                  | March<br>31,                          | June 30, | September<br>30, | December<br>31, |
|                                  | (In thousands, except per share data) |          |                  |                 |
| 2015                             |                                       |          |                  |                 |
| Revenues                         | \$85,989                              | \$88,361 | \$ 93,991        | \$ 95,308       |
| Income before income tax expense | 14,749                                | 15,200   | 15,649           | 15,783          |
| Net income                       | 8,333                                 | 8,537    | 8,843            | 8,967           |
| Earnings per share:              |                                       |          |                  |                 |
| Basic                            | \$0.33                                | \$0.33   | \$ 0.34          | \$ 0.35         |
| Diluted                          | 0.26                                  | 0.27     | 0.28             | 0.29            |
| 2014                             |                                       |          |                  |                 |
| Revenues                         | \$68,146                              | \$71,594 | \$ 77,050        | \$ 83,467       |
| Income before income tax expense | 11,764                                | 12,329   | 13,804           | 14,346          |
| Net income                       | 6,705                                 | 7,026    | 7,776            | 8,010           |
| Earnings per share:              |                                       |          |                  |                 |
| Basic                            | \$0.28                                | \$0.28   | \$ 0.31          | \$ 0.31         |
| Diluted                          | 0.21                                  | 0.22     | 0.24             | 0.25            |
| 2013                             |                                       |          |                  |                 |
| Revenues                         | \$54,594                              | \$70,482 | \$ 64,066        | \$ 66,634       |
| Income before income tax expense | 6,528                                 | 8,546    | 10,559           | 11,540          |
| Net income                       | 3,785                                 | 4,825    | 5,873            | 6,522           |
| Earnings per share:              |                                       |          |                  |                 |
| Basic                            | \$0.19                                | \$0.23   | \$ 0.27          | \$ 0.28         |
| Diluted                          | 0.12                                  | 0.15     | 0.19             | 0.21            |

*(15) Subsequent Events*

On January 27, 2016 we executed our first securitization of 2016. In the transaction, qualified institutional buyers purchased \$329.5 million of asset-backed notes secured by \$340.0 million in automobile receivables purchased by us. The sold notes, issued by CPS Auto Receivables Trust 2016-A, consist of five classes. Ratings of the notes were provided by Standard & Poor's and DBRS and were based on the structure of the transaction, the historical

performance of similar receivables and our experience as a servicer. We retained the most subordinated notes, Class F, in the principal amount of \$10,540,000. The weighted average yield on the notes, including the retained notes, is approximately 4.34%.

The 2016-A transaction has initial credit enhancement consisting of a cash deposit equal to 1.00% of the original receivable pool balance. The final enhancement level requires accelerated payment of principal on the notes to reach overcollateralization of 4.00% of the then-outstanding receivable pool balance. The transaction utilizes a pre-funding structure, in which CPS sold approximately \$255.9 million of receivables on January 27, 2016 and sold \$84.1 million of additional receivables on February 5, 2016.

The transaction was a private offering of securities, not registered under the Securities Act of 1933, or any state securities law.