

CONSUMER PORTFOLIO SERVICES INC
Form 10-Q
October 30, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2013

Commission file number: 1-11416

CONSUMER PORTFOLIO SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

1950 Jamboree Road, Irvine, California 92612
(Address of principal executive offices) (Zip Code)

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

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

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

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

Large Accelerated Filer £ Accelerated Filer £

Non-Accelerated Filer £ Smaller Reporting Company T

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

As of October 22, 2013 the registrant had 22,274,010 common shares outstanding.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

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Item 1. Financial Statements**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share data)**

	September 30, 2013	December 31, 2012
ASSETS		
Cash and cash equivalents	\$24,128	\$12,966
Restricted cash and equivalents	129,450	104,445
Finance receivables	1,081,282	764,343
Less: Allowance for finance credit losses	(34,464)	(19,594)
Finance receivables, net	1,046,818	744,749
Finance receivables measured at fair value	21,217	59,668
Residual interest in securitizations	1,426	4,824
Furniture and equipment, net	607	726
Deferred financing costs	11,163	9,140
Deferred tax assets, net	66,166	75,640
Accrued interest receivable	15,146	10,411
Other assets	17,391	15,051
	\$1,333,512	\$1,037,620
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$33,817	\$17,785
Warehouse lines of credit	26,959	21,731
Residual interest financing	20,000	13,773
Debt secured by receivables measured at fair value	16,888	57,107
Securitization trust debt	1,094,559	792,497
Senior secured debt, related party	38,963	50,135
Subordinated renewable notes	20,640	23,281
	1,251,826	976,309
COMMITMENTS AND CONTINGENCIES		
Shareholders' Equity		
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	—	—
	71,570	65,678

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Common stock, no par value; authorized 75,000,000 shares; 22,150,560 and 19,838,913 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively

Retained earnings	15,753	1,270
Accumulated other comprehensive loss	(5,637)	(5,637)
	81,686	61,311
	\$1,333,512	\$1,037,620

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Interest income	\$60,462	\$45,053	\$167,426	\$127,210
Servicing fees	700	502	2,484	1,897
Other income	2,904	2,365	8,284	7,481
Gain on cancellation of debt	–	–	10,947	–
	64,066	47,920	189,141	136,588
Expenses:				
Employee costs	11,199	8,730	31,675	25,878
General and administrative	4,074	3,690	12,346	11,765
Interest	13,853	19,560	44,800	61,696
Provision for credit losses	20,220	9,465	52,739	22,012
Provision for contingent liabilities	–	–	9,650	–
Marketing	3,378	2,906	10,032	8,086
Occupancy	695	723	1,921	2,170
Depreciation and amortization	88	118	345	401
	53,507	45,192	163,508	132,008
Income before income tax expense	10,559	2,728	25,633	4,580
Income tax expense	4,686	–	11,150	–
Net income	\$5,873	\$2,728	\$14,483	\$4,580
Earnings per share:				
Basic	\$0.27	\$0.14	\$0.69	\$0.24
Diluted	0.19	0.11	0.46	0.19
Number of shares used in computing earnings per share:				
Basic	21,795	19,495	20,959	19,406
Diluted	31,217	25,695	31,550	24,026

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income	\$5,873	\$2,728	\$14,483	\$4,580
Other comprehensive income/(loss); change in funded status of pension plan	—	—	—	—
Comprehensive income	\$5,873	\$2,728	\$14,483	\$4,580

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net income	\$ 14,483	\$ 4,580
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of deferred acquisition fees	(15,543)	(11,370)
Accretion of purchase discount on receivables measured at fair value	(1,247)	(7,272)
Amortization of discount on securitization trust debt	53	1,371
Amortization of discount on senior secured debt, related party	1,681	2,308
Accretion of premium on debt secured by receivables measured at fair value	2,079	5,552
Mark to fair value on debt secured by receivables measured at fair value	(933)	1,953
Mark to fair value of receivables measured at fair value	595	(1,824)
Depreciation and amortization	345	401
Amortization of deferred financing costs	2,874	3,952
Provision for credit losses	52,739	22,012
Provision for contingent liabilities	9,650	-
Stock-based compensation expense	2,939	801
Interest income on residual assets	-	(458)
Gain on cancellation of debt	(10,947)	-
Changes in assets and liabilities:		
Accrued interest receivable	(4,735)	(2,387)
Deferred tax assets, net	9,474	-
Other assets	680	1,350
Accounts payable and accrued expenses	6,965	(4,540)
Net cash provided by operating activities	71,152	16,429
Cash flows from investing activities:		
Purchases of finance receivables held for investment	(592,327)	(400,908)
Payments received on finance receivables held for investment	253,062	226,395
Payments on receivables portfolio at fair value	39,103	91,865
Proceeds received on residual interest in securitizations	3,398	-
Change in repossessions held in inventory	(3,020)	(221)
Decreases (increases) in restricted cash and cash equivalents, net	(25,005)	51,988
Purchase of furniture and equipment	(226)	(326)
Net cash used in investing activities	(325,015)	(31,207)
Cash flows from financing activities:		
Proceeds from issuance of securitization trust debt	595,000	443,500
Proceeds from issuance of subordinated renewable notes	1,380	2,609
Payments on subordinated renewable notes	(4,021)	(1,834)

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Net proceeds from (repayments of) warehouse lines of credit	5,228	(4,995)
Net proceeds from (repayments of) residual interest financing debt	6,227	(8,111)
Repayment of securitization trust debt	(282,044)	(306,540)
Repayment of debt secured by receivables measured at fair value	(41,365)	(97,703)
Repayment of senior secured debt, related party	(12,852)	(6,200)
Payment of financing costs	(4,898)	(5,638)
Repurchase of common stock	(2,484)	(435)
Exercise of options and warrants	4,854	499
Net cash provided by financing activities	265,025	15,152
Increase in cash and cash equivalents	11,162	374
Cash and cash equivalents at beginning of period	12,966	10,094
Cash and cash equivalents at end of period	\$24,128	\$10,468

Supplemental disclosure of cash flow information:

Cash paid during the period for:

Interest	\$41,936	\$63,258
Income taxes	\$2,058	\$963

Non-cash financing activities:

Derivative warrants reclassified from accounts payable to common stock	\$583	\$1,307
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See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Description of Business

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

Basis of Presentation

Our Unaudited Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America, with the instructions to Form 10-Q and with Article 8 of Regulation S-X of the Securities and Exchange Commission, and include all adjustments that are, in management’s opinion, necessary for a fair presentation of the results for the interim periods presented. All such adjustments are, in the opinion of management, of a normal recurring nature. Results for the nine-month period ended September 30, 2013 are not necessarily indicative of the operating results to be expected for the full year.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted from these Unaudited Condensed Consolidated Financial Statements. These Unaudited Condensed Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements and Notes to Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2012.

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, valuing finance receivables measured at fair value and the related debt, valuing residual interest in securitizations, accreting net acquisition fees, amortizing deferred costs, valuing stock options and warrants issued, 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.

CONSUMER PORTFOLIO SERVICES, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Other Income**

The following table presents the primary components of Other Income for the three-month and nine-month periods ending September 30, 2013 and 2012:

	Three Months Ended September 30, 2013 2012		Nine Months Ended September 30, 2013 2012	
	(In thousands)		(In thousands)	
Direct mail revenues	\$1,691	\$1,617	\$5,418	\$4,468
Convenience fee revenue	720	715	2,235	2,237
Recoveries on previously charged-off contracts	49	67	153	312
Sales tax refunds	–	59	84	186
Other	444	(93)	394	278
Other income for the period	\$2,904	\$2,365	\$8,284	\$7,481

Stock-based Compensation

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

For the nine months ended September 30, 2013 and 2012, we recorded stock-based compensation costs in the amount of \$2,939,000 and \$801,000, respectively. As of September 30, 2013, unrecognized stock-based compensation costs to be recognized over future periods equaled \$13.5 million. This amount will be recognized as expense over a weighted-average period of 3.6 years.

The following represents stock option activity for the nine months ended September 30, 2013:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at the beginning of period	8,652	\$ 1.58	N/A
Granted	3,040	7.43	N/A
Exercised	(1,116)	1.52	N/A
Forfeited	(151)	4.64	N/A
Options outstanding at the end of period	10,425	\$ 3.25	6.63 years
Options exercisable at the end of period	5,769	\$ 1.95	4.90 years

At September 30, 2013, the aggregate intrinsic value of options outstanding and exercisable was \$32.5 million and \$23.3 million, respectively. There were 1,116,000 options exercised for the nine months ended September 30, 2013 compared to 356,000 for the comparable period in 2012. There were 4.0 million shares available for future stock option grants under existing plans as of September 30, 2013.

Purchases of Company Stock

During the nine-month period ended September 30, 2013 and 2012, we purchased 323,674 and 320,154 shares, respectively, of our common stock, at average prices of \$7.68 and \$1.36, respectively.

Reclassifications

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

CONSUMER PORTFOLIO SERVICES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Derivative Financial Instruments

We do not use derivative financial instruments to hedge exposures to cash flow or market risks. However, from 2008 to 2010, we issued warrants to purchase the Company's common stock in conjunction with various debt financing transactions. At the time of issuance, five of these warrants issued contained "down round," or price reset, features that are subject to classification as liabilities for financial statement purposes. These liabilities were measured at fair value, with the changes in fair value at the end of each period reflected as current period income or loss. Accordingly, changes to the market price per share of our common stock underlying these warrants with "down round," or price reset, features directly affected the fair value computations for these derivative financial instruments. The effect was that any increase in the market price per share of our common stock would also increase the related liability, which in turn would result in a current period loss. Conversely, any decrease in the market price per share of our common stock would also decrease the related liability, which in turn would result in a current period gain. We used a binomial pricing model to compute the fair value of the liabilities associated with the outstanding warrants. In computing the fair value of the warrant liabilities at the end of each period, we used significant judgments with respect to the risk free interest rate, the volatility of our stock price, and the estimated life of the warrants. The warrant liabilities were included in Accounts payable and accrued expenses on our consolidated balance sheets. On March 29, 2012 we agreed with the holders to amend three of the five warrants that contained the "down round" features, removing those specific price reset terms. On the date of the amendment, we valued each of the three warrants using a binomial pricing model as described above. The aggregate value of the three amended warrants of \$1.1 million was then reclassified from Accounts payable to Common Stock. On June 25, 2012 we agreed with the holder to amend one other warrant that contained the "down round" features, removing those specific price reset terms. The \$250,000 aggregate value of this amended warrant was reclassified from Accounts payable to Common stock on the date of the amendment. The fifth warrant with the "down round" feature was exercised on February 22, 2013. The \$583,000 intrinsic value of this warrant was reclassified from Accounts payable to Common stock on the date of the exercise. As of September 30, 2013 all five of the warrants issued that previously contained price reset features have either been amended or exercised and are no longer subject to quarterly valuations.

Financial Covenants

Certain of our securitization transactions, our warehouse credit facilities and our residual interest financing contain various financial covenants requiring minimum financial ratios and results. Such covenants include maintaining minimum levels of liquidity and net worth and not exceeding maximum leverage levels. As of September 30, 2013, we were in compliance with all such covenants. In addition, certain securitization and non-securitization related debt agreements contain cross-default provisions that would allow certain creditors to declare a default if a default occurred under a different facility.

Finance Receivables and Related Debt Measured at Fair Value

In September 2011 we purchased approximately \$217.8 million of finance receivables from Fireside Bank. These receivables and the related acquisition debt are recorded on our balance sheet at fair value. There are no level 1 or level 2 inputs (as described by ASC 820) available to us for measurement of such receivables, or for the related debt. 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. 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.

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 holds 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.

CONSUMER PORTFOLIO SERVICES, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Provision for Contingent Liabilities**

During the nine months ended September 30, 2013, we recognized \$9.7 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 the we refrain from certain allegedly unfair trade practices, and make restitutionary payments into a consumer relief fund.

(2) Finance Receivables

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

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

	September 30, 2013	December 31, 2012
	(In thousands)	
Finance Receivables		
Automobile finance receivables, net of unearned interest	\$1,111,773	\$795,786
Less: Unearned acquisition fees and originations costs	(30,491)	(31,443)
Finance Receivables	\$1,081,282	\$764,343

We consider an automobile contract delinquent when an obligor fails to make at least 90% of a contractually due payment by the following due date, which date may have been extended within limits specified in the servicing agreements. The period of delinquency is based on the number of days payments are contractually past due, as extended where applicable. Automobile contracts less than 31 days delinquent are not included. In certain circumstances we will grant obligors one-month payment extensions to assist them with temporary cash flow problems. The only modification of terms is to advance the obligor's next due date by one month and extend the maturity date of the receivable by one month. In 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 following table summarizes the delinquency status of finance receivables as of September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
	(In thousands)	
Delinquency Status		
Current	\$1,061,090	\$764,741
31 - 61 days	26,335	16,925
61 - 90 days	16,084	9,019
91 + days	8,264	5,101
	\$1,111,773	\$795,786

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

Finance receivables totaling \$8.3 million and \$5.1 million at September 30, 2013 and December 31, 2012, respectively, including all receivables greater than 90 days delinquent, have been placed on non-accrual status as a result of their delinquency status.

We use a loss allowance methodology commonly referred to as "static pooling," which stratifies our finance receivable portfolio into separately identified pools based on the period of origination. Using analytical and formula driven techniques, we estimate an allowance for finance credit losses, which we believe is adequate for probable credit losses that can be reasonably estimated in our portfolio of automobile contracts. The estimate for probable credit losses is reduced by our estimate for future recoveries on previously incurred losses. Provision for losses is charged to our consolidated statement of operations. Net losses incurred on finance receivables are charged to the allowance. For finance receivables originated through December 31, 2010 we established the allowance at the time of the acquisition of the receivable. Beginning January 1, 2011, we establish the allowance for new receivables over the 12-month period following their acquisition.

The following table presents a summary of the activity for the allowance for finance credit losses for the three-month and nine-month periods ended September 30, 2013 and 2012:

	Three Months Ended		Nine Months Ended	
	September 30, 2013	September 30, 2012	September 30, 2013	September 30, 2012
	(In thousands)		(In thousands)	
Balance at beginning of period	\$32,101	\$14,093	\$19,594	\$10,351
Provision for credit losses on finance receivables	20,220	9,465	52,739	22,012
Charge-offs	(20,952)	(9,578)	(47,229)	(26,158)
Recoveries	3,095	2,966	9,360	10,741
Balance at end of period	\$34,464	\$16,946	\$34,464	\$16,946

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

	September 30, 2013	December 31, 2012
	(In thousands)	
Gross balance of repossessions in inventory	\$20,718	\$ 12,102
Allowance for losses on repossessed inventory	(11,980)	(6,384)
Net repossessed inventory included in other assets	\$8,738	\$ 5,718

(3) Finance Receivables Measured at Fair Value

In September 2011 we purchased approximately \$217.8 million of finance receivables from Fireside Bank. These receivables are recorded on our balance sheet at fair value.

The following table presents the components of Finance Receivables measured at fair value:

	September 30, 2013	December 31, 2012
Finance Receivables Measured at Fair Value	(In thousands)	
Finance receivables and accrued interest, net of unearned interest	\$ 21,701	\$ 60,804
Less: Fair value adjustment	(484)	(1,136)
Finance receivables measured at fair value	\$ 21,217	\$ 59,668

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

The following table summarizes the delinquency status of finance receivables measured at fair value as of September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
	(In thousands)	
Delinquency Status		
Current	\$ 19,795	\$ 57,557
31 - 60 days	1,218	2,206
61 - 90 days	436	710
91 + days	252	331
	\$21,701	\$ 60,804

(4) Securitization Trust Debt

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

Series	Final Scheduled Payment Date (1)	Receivables Pledged at September 30, 2013	Initial Principal	Outstanding Principal at September 30, 2013	Outstanding Principal at December 31, 2012	Weighted Average Contractual Interest Rate at September 30, 2013
(Dollars in thousands)						
CPS 2008-A	October 2014	\$-	\$310,359	\$-	\$ 40,713	-
Page Five Funding	January 2018	13,244	46,058	11,500	21,251	9.39%
CPS 2011-A	April 2018	33,088	100,364	29,533	48,368	3.54%
CPS 2011-B	September 2018	50,758	109,936	50,286	70,863	4.70%
CPS 2011-C	March 2019	63,410	119,400	63,429	88,269	5.03%
CPS 2012-A	June 2019	73,288	155,000	72,964	105,485	3.58%
CPS 2012-B	September 2019	96,641	141,500	95,324	122,329	3.24%

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CPS 2012-C	December 2019	103,877	147,000	101,575	135,219	2.56%
CPS 2012-D	March 2020	124,318	160,000	118,237	160,000	2.12%
CPS 2013-A	June 2020	165,276	185,000	157,015	–	1.85%
CPS 2013-B	September 2020	192,628	205,000	189,696	–	2.28%
CPS 2013-C	December 2020	137,989	205,000	205,000	–	2.36%
		\$1,054,517	\$1,884,617	\$1,094,559	\$792,497	

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 (1)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 \$104.7 million in 2013, \$393.4 million in 2014, \$292.0 million in 2015, \$181.0 million in 2016, \$96.8 million in 2017 and \$26.6 million in 2018.

CONSUMER PORTFOLIO SERVICES, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The terms of the securitization agreements related to the issuance of the securitization trust debt and the warehouse credit facilities require that we meet certain delinquency and credit loss criteria with respect to the pool of receivables, and certain of the agreements require that we maintain minimum levels of liquidity and not exceed maximum leverage levels. In addition, certain securitization and non-securitization related debt contain cross-default provisions, which would allow certain creditors to declare a default if a default were declared under a different facility. As of September 30, 2013, we were in compliance with all such covenants.

We are responsible for the administration and collection of the automobile contracts. The securitization agreements also require certain funds be held in restricted cash accounts to provide additional collateral for the borrowings, to be applied to make payments on the securitization trust debt or as pre-funding proceeds from a term securitization prior to the purchase of additional collateral. As of September 30, 2013, restricted cash under the various agreements totaled approximately \$129.5 million, of which \$65.8 million represented pre-funding proceeds. Interest expense on the securitization trust debt consists of the stated rate of interest plus amortization of additional costs of borrowing. Additional costs of borrowing include facility fees, amortization of deferred financing costs and discounts on notes sold. Deferred financing costs and discounts on notes sold related to the securitization trust debt are amortized using a level yield method. Accordingly, the effective cost of the securitization trust debt is greater than the contractual rate of interest disclosed above.

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

CONSUMER PORTFOLIO SERVICES, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(5) Debt**

The terms and amounts of our other debt outstanding at September 30, 2013 and December 31, 2012 are summarized below:

<u>Description</u>	<u>Interest Rate</u>	<u>Maturity</u>	Amount Outstanding at	
			September 30, 2013	December 31, 2012
Residual interest financing	12.875% over one month Libor	September 2013	\$—	\$13,773
	11.75% over one month Libor	April 2018	20,000	—
Senior secured debt, related party	13.0% and 16.0% at September 30, 2013 and December 31, 2012, respectively	June 2014	36,816	50,135
	5.00%	June 2014	2,147	—
Subordinated renewable notes	Weighted average rate of 12.7% and 14.4% at September 30, 2013 and December 31, 2012, respectively	Weighted average maturity of July 2016 and June 2015 at September 30, 2013 and December 31, 2012, respectively	20,640	23,281
Debt secured by receivables measured at fair value	n/a	Repayment is based on payments from underlying receivables. Final payment of the 8.00% note was made in September 2013, with residual payments extending through 2016	16,888	57,107
			\$96,491	\$144,296

In April 2013 we entered into a new \$20 million five-year residual financing facility secured by eligible residual assets in two previously securitized pools of automobile receivables. We also prepaid \$15 million of our senior secured debt in April 2013 and reduced the interest rate on the remaining outstanding amount from 16.00% to 13.00%. The maturity date on the remaining outstanding amount was extended from December 2013 to June 2014.

CONSUMER PORTFOLIO SERVICES, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(6) Interest Income and Interest Expense**

The following table presents the components of interest income:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012		2012	
	(In thousands)		(In thousands)	
Interest on Finance Receivables	\$60,462	\$44,808	\$167,416	\$126,029
Residual interest income	–	–	–	458
Other interest income	–	245	10	723
Interest income	\$60,462	\$45,053	\$167,426	\$127,210

The following table presents the components of interest expense:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	2012		2012	
	(In thousands)		(In thousands)	
Securitization trust debt	\$8,357	\$9,398	\$25,725	\$28,557
Warehouse lines of credit	1,447	2,179	4,026	5,243
Senior secured debt, related party	1,599	3,077	6,474	9,873
Debt secured by receivables at fair value	623	3,275	3,435	13,362
Residual interest financing	1,079	731	2,666	2,125
Subordinated renewable notes	748	900	2,474	2,536
	\$13,853	\$19,560	\$44,800	\$61,696

CONSUMER PORTFOLIO SERVICES, INC.**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS*****(7) Earnings Per Share***

Earnings per share for the three-month and nine-month periods ended September 30, 2013 and 2012 were calculated using the weighted average number of shares outstanding for the related period. The following table reconciles the number of shares used in the computations of basic and diluted earnings per share for the three-month and nine-month periods ended September 30, 2013 and 2012:

	Three Months Ended September 30, 2013 2012 (In thousands)		Nine Months Ended September 30, 2013 2012 (In thousands)	
Weighted average number of common shares outstanding during the period used to compute basic earnings per share	21,795	19,495	20,959	19,406
Incremental common shares attributable to exercise of outstanding options and warrants	9,422	6,200	10,591	4,620
Weighted average number of common shares used to compute diluted earnings per share	31,217	25,695	31,550	24,026

If the anti-dilutive effects of common stock equivalents were considered, shares included in the diluted earnings per share calculation for the three-month and nine-month periods ended September 30, 2013 would have included an additional 3.1 million and 1.9 million shares, respectively, attributable to the exercise of outstanding options and warrants. For the three-month and nine-month periods ended September 30, 2012, the anti-dilutive shares were 1.3 million and 2.3 million, respectively.

(8) Income Taxes

We file numerous consolidated and separate income tax returns with the United States and with many states. With few exceptions, we are no longer subject to U.S. federal, state, or local examinations by tax authorities for years before 2008.

We do not anticipate that total unrecognized tax benefits will significantly change due to any settlements of audits or expirations of statutes of limitations over the next 12 months.

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

Deferred tax assets are recognized subject to management's judgment that realization is more likely than not. A valuation allowance is recognized for a deferred tax asset if, based on the weight of the available evidence, it is more likely than not that some portion of the deferred tax asset will not be realized. In making such judgments, significant weight is given to evidence that can be objectively verified. As a result of the unprecedented adverse changes in the market for securitizations, the recession and the resulting high levels of unemployment that occurred in 2008 and 2009, we incurred substantial operating losses from 2009 through 2011 which led us to establish a valuation allowance against a substantial portion of our deferred tax assets. However, since the fourth quarter of 2011, we have reported eight consecutive quarters of increasing profitability, observed improvement in credit metrics, and produced reliable internal financial projections. Furthermore, we have demonstrated an ability to increase our volumes of contract purchases, grow our managed portfolio and obtain cost effective short-term and long-term financing for our finance receivables. As a result of these and other factors, we determined at December 31, 2012 that, based on the weight of t