ONYX ACCEPTANCE CORP
Form 10-Q
November 14, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2001

OR

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

FOR THE TRANSITION PERIOD FROM ______ TO ______

COMMISSION FILE NUMBER: 28050

ONYX ACCEPTANCE CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	33-0577635 (I.R.S. EMPLOYER IDENTIFICATION NO.)

ONYX ACCEPTANCE CORPORATION
27051 TOWNE CENTRE DRIVE
FOOTHILL RANCH, CA 92610
(949) 465-3900
(ADDRESS AND TELEPHONE NUMBER OF PRINCIPAL EXECUTIVE OFFICES)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES [X] NO [ ]

As of November 14, 2001, there were 5,078,046 shares of registrant s Common Stock, par value $.01 per share outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

ASSETS

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	(UNAUDITED)	(AUDITED)
	(DOLLARS IN THOUSANDS)	
Cash and cash equivalents	$ 5,975	$ 3,130
Credit enhancement assets	182,839	146,013
Contracts held for sale (Net of allowance)	204,090	170,755
Other assets	10,541	11,482
Total assets	$403,445	$ 331,380
LIABILITIES		
Accounts payable	$ 30,562	$ 22,706
Debt	282,436	233,152
Other liabilities	27,669	19,929
Total liabilities	340,667	275,787
EQUITY		
Common stock		
Par value $.01 per share; authorized 15,000,000 shares; issued and outstanding 5,078,046 as of September 30, 2001 and 4,989,504 as of December 31, 2000	51	50
Paid in capital	32,647	32,601
Retained earnings	25,601	21,550
Accumulated other comprehensive income, net of tax	4,479	1,392
Total equity	62,778	55,593
Total liabilities and equity	$403,445	$ 331,380

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	**2000**	**2001**	**2000**
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (UNAUDITED)		(UNAUDITED)	
REVENUES:				
Interest income	$ 9,401	$ 3,098	$ 25,007	$ 16,433
Interest expense	1,943	2,814	9,027	11,100
Net interest income	7,458	284	15,980	5,333
Gain on sale of contracts	6,591	12,066	26,167	38,811
Service fee income	12,368	13,853	38,177	32,811
Total Revenues	26,417	26,203	80,324	76,955
EXPENSES:				
Provision for credit losses	502	(73)	966	645
Interest expense other	1,718	1,473	4,781	3,985
OPERATING EXPENSES:				
Salaries and benefits	13,228	11,299	39,895	35,370
Systems and servicing	476	1,261	3,573	4,324
Telephone and data lines	1,201	1,501	3,680	4,656
Depreciation	1,094	1,170	3,568	3,191
General and administrative expenses	5,957	6,648	16,989	16,326
Total Operating Expenses	21,956	21,879	67,705	63,867
Total Expenses	24,176	23,279	73,452	68,497
Income before Income Taxes	2,241	2,924	6,872	8,458
Income Taxes	899	1,213	2,821	3,510
Net Income	$ 1,342	$ 1,711	$ 4,051	$ 4,948
Net Income per share Basic	$ 0.27	$ 0.32	$ 0.81	$ 0.85
Net Income per share Diluted	$ 0.25	$ 0.32	$ 0.78	$ 0.82
Basic Shares Outstanding	5,047,292	5,266,005	5,008,767	5,839,528
Diluted Shares Outstanding	5,354,351	5,423,108	5,214,455	5,999,130

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY
(IN THOUSANDS)
(UNAUDITED)

	SHARES	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED COMPREHENSIVE GAIN (LOSS), NET OF TAX	TOTAL
BALANCE, DECEMBER 31, 2000	4,990	$ 50	$ 32,601	$ 21,550	$ 1,392	$55,593
Stock issued from warrants/options exercised	88	1	46			47
Comprehensive income:						
Unrealized gains in securitized assets, net of tax of $2.9 million					4,126	4,126
Adoption of FAS 133, net of tax of $596 thousand					(840)	(840)
Loss on derivatives reclassified to earnings net of tax of $596 thousand					840	840
Unrealized loss on hedging activities, net of tax of $696 thousand					(1,039)	(1,039)
Net income				4,051		4,051
Total comprehensive income				4,051	3,087	7,138
BALANCE, SEPTEMBER 30, 2001	5,078	$ 51	$ 32,647	$ 25,601	$ 4,479	$62,778

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000
	(DOLLARS IN THOUSANDS) (UNAUDITED)	
OPERATING ACTIVITIES:		
Net cash (used in) provided by operating activities	$ (44,552)	$ 82,928
INVESTING ACTIVITIES:		
Purchases of property and equipment	(2,140)	(3,404)
FINANCING ACTIVITIES:		
Proceeds from exercise of warrants and employee options	47	6
Repurchase of common stock		(4,380)
Proceeds (payments) on capital lease obligations	206	(233)
Payments on residual lines of credit	(13,884)	(46,630)
Proceeds from drawdown on residual lines of credit	32,600	29,000
Paydown of warehouse lines related to Securitizations	(925,310)	(1,046,489)
Proceeds from warehouse lines	958,305	977,708
Proceeds from issuance of subordinated debt		11,518
Principal payments on subordinated debt	(2,427)	(1,725)
Payments on other loans		(199)
Net cash provided by (used in) financing activities	49,537	(81,424)
Increase (decrease) in cash and cash equivalents	2,845	(1,900)
Cash and cash equivalents at beginning of period	3,130	5,190
Cash and cash equivalents at end of period	$ 5,975	$ 3,290

See the accompanying notes to the condensed consolidated financial statements.

ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

The condensed consolidated financial statements included herein are unaudited and have been prepared by Onyx Acceptance Corporation (Onyx or the Company) in accordance with generally accepted accounting principles for interim financial reporting and Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the regulations. In the opinion of management, the financial statements reflect all adjustments (of a normal and recurring nature), which are necessary to present fairly the financial position, results of operations and cash flows for the interim period. Operating results for the three and nine months ended September 30, 2001 are not necessarily indicative of the results that may be expected for the year ending December 31, 2001. The condensed consolidated financial statements should be read in conjunction with the audited financial statements and footnotes thereto for the year ended December 31, 2000 included in the Company s 2000 Annual Report on Form 10-K.

USE OF ESTIMATES

In conformity with generally accepted accounting principles, management utilizes assumptions and estimates that affect the reported values of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for each reporting period. The more significant estimates made in the preparation of the Company s condensed consolidated financial statements relate to the credit enhancement assets and the gain on sale of motor vehicle retail installment sales and loan contracts (Contracts). Such assumptions include, but are not limited to, estimates of loan prepayments, defaults, recovery rates and present value discount rates. The Company uses a combination of its own historical experience and expectation of future performance to determine such estimates. Actual results may differ from the Company s estimates due to numerous factors both within and beyond the control of Company management. Changes in these factors could require the Company to revise its assumptions concerning the amount of voluntary prepayments, the frequency and/or severity of defaults and the recovery rates associated with the disposition of repossessed vehicles.

RECLASSIFICATION

Certain amounts in the prior quarter and year to date condensed consolidated financial statements have been reclassified to conform to the corresponding 2001 presentation.

NOTE 2 CONTRACTS HELD FOR SALE

Contracts held for sale consisted of the following:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	(IN THOUSANDS)	
Gross contracts held for sale	$209,504	$ 177,086
Less unearned interest	(1,979)	(3,302)
Contracts held for sale	207,525	173,784
Allowance for credit losses	(1,341)	(1,175)
Dealer participation	(2,094)	(1,854)
Total	$204,090	$ 170,755

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

NOTE 3 CREDIT ENHANCEMENT ASSETS

Credit enhancement assets consisted of the following:

	SEPTEMBER 30, 2001	DECEMBER 31, 2000
	(IN THOUSANDS)	
Trust receivable	$ 7,693	$ 7,510
RISA	175,146	138,503
Total	$ 182,839	$ 146,013

Retained interest in securitized assets (RISA) capitalized upon securitization of Contracts represent the present value of the estimated future earnings to be received by the Company from the excess spread created in securitization transactions. Excess spread is calculated by taking the difference between the coupon rate of the Contracts sold and the weighted average security rate paid to the investors less contractually specified servicing and guarantor fees and projected credit losses, after giving effect to estimated prepayments.

Prepayment and credit loss assumptions are utilized to project future earnings and are based on historical experience. Credit losses are estimated using cumulative loss frequency and severity estimates by management. All assumptions are evaluated each quarter and adjusted, if appropriate, to reflect the actual performance of the underlying Contracts. Future earnings are discounted at a rate management believes to be representative of market at the time of securitization.

During 1999, the Emerging Issues Task Force (EITF) issued EITF 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets. EITF 99-20 establishes new income and impairment recognition standards for interests in certain securitized assets. Under the provisions of EITF 99-20, the holder of beneficial interests should recognize the excess of all estimated cash flows attributable to the beneficial interest estimated at the acquisition date over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the estimated cash flows change, then the holder of the beneficial interest should recalculate the accretable yield and adjust the periodic accretion recognized as income prospectively. If the fair value of a beneficial interest has declined below its carrying amount, an other-than-temporary decline is considered to exist if there has been a decline in estimated future cash flows and the difference between the carrying value and fair value of the beneficial interest is recorded as an impairment loss through the income statement.

Effective April 1, 2001, the Company adopted EITF 99-20. Prior to the adoption of EITF 99-20, the balance of RISA was amortized against actual excess spread income earned on a monthly basis over the expected repayment life of the underlying Contracts. The adoption of EITF 99-20 resulted in amounts previously recognized as service fee income being recognized as interest income.

The following table presents the balances and activity for RISA:

	NINE MONTHS ENDED SEPTEMBER 30, 2001	YEAR ENDED DECEMBER 31, 2000

	(IN THOUSANDS)	
Beginning Balance	$138,503	$ 137,171
Additions	62,352	109,173
Amortization	(32,702)	(61,229)
Sale of RISA		(49,924)
Change in unrealized gain on securities available for sale	6,993	3,312
Ending Balance	$175,146	$ 138,503

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

In initially valuing the RISA, the Company establishes an off balance sheet allowance for probable future credit losses. The allowance is based upon historical experience and management s estimate of other factors that may affect portfolio performance. The amount is reviewed periodically and adjustments are made if actual experience or other factors indicate that future performance may differ from management s prior estimates.

The following table presents the estimated future undiscounted retained interest earnings to be received from securitizations. Estimated future undiscounted RISA earnings are calculated by taking the difference between the weighted average annual percentage rate of the Contracts sold and the weighted average security rate paid to the investors, less the contractually specified servicing fee of 1.0% and financial insurance fees, after giving effect to estimated prepayments and assuming no losses. To arrive at the RISA, this amount is reduced by the off balance sheet allowance established for probable future losses and by discounting to present value at the current market discount rates.

	SEPTEMBER, 2001	DECEMBER 31, 2000
	(IN THOUSANDS)	
Estimated net undiscounted RISA earnings	$ 325,024	$ 286,125
Off balance sheet allowance for losses	(117,281)	(116,086)
Discount to present value	(32,597)	(31,536)
Retained interest in securitized assets	$ 175,146	$ 138,503
Outstanding balance of Contracts sold through Securitizations	$2,654,213	$ 2,513,407

NOTE 4 NET INCOME PER SHARE

The following table sets forth the computation of basic and diluted net income per share (EPS):

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
	(IN THOUSANDS, EXCEPT $ PER SHARE)			
Net Income	$1,342	$1,711	$4,051	$4,948
Weighted average shares outstanding	5,047	5,266	5,009	5,840
Net effect of dilutive stock options/warrants	307	157	205	159
Diluted weighted average shares outstanding	5,354	5,423	5,214	5,999
Net income per share:				
Basic EPS	$ 0.27	$ 0.32	$ 0.81	$ 0.85
Diluted EPS	$ 0.25	$ 0.32	$ 0.78	$ 0.82

NOTE 5 ADOPTION OF SFAS NO. 133

Effective January 1, 2001 Onyx adopted the provisions of Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), as amended. SFAS No. 133 requires companies to record derivatives on the balance sheet as assets and liabilities, measured at fair value. The accounting for the gain or loss due to changes in fair value of the derivative instrument depends on whether the derivative qualifies as a hedge. If the derivative instrument does not qualify as a hedge, the gains or losses are reported in earnings when they occur. If the derivative instrument qualifies as a hedge, the accounting varies based upon the type of risk being hedged.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

Adopting the provisions of SFAS No. 133 on January 1, 2001 resulted in a one-time cumulative after-tax reduction in Accumulated Other Comprehensive Income as of January 1, 2001, of $840,000, representing the fair value of the derivatives net of tax.

All components of each derivative s gain or loss were included in the assessment of hedge effectiveness. The Company has reclassified to earnings $840,000 of its loss from adoption, which was recorded in Accumulated Other Comprehensive Income when the forecasted transaction occurred during the first quarter of 2001.

Cash Flow Hedges

Onyx maintains an overall risk management strategy that incorporates the use of interest rate and derivative financial instruments to mitigate its exposure to significant unplanned fluctuations in earnings caused by volatility in interest rates. Derivative instruments that are used as part of the Company s interest rate management strategy include forward interest rate swaps. These instruments are designated as cash flow hedges. Onyx does not use any of these instruments for trading or speculative purposes.

The Company uses forward interest rate swaps to hedge the variability in the forecasted future net cash flows it will receive from the RISA attributable to the risk of changing interest rates. The Company s interest rate swap agreements involve arrangements to pay a fixed interest rate and receive a floating interest rate, at specified intervals, calculated on agreed-upon amortizing notional amounts. The debt and amounts that the Company hedges are determined based on prevailing market conditions and the current shape of the yield curve. Interest rate swap agreements are executed as an integral part of specific securitization transactions. Interest rate swap agreements are unwound upon securitization, whereby the gain or loss on the hedge is recorded to income and the associated component of the gain or loss previously recorded in other comprehensive income is reversed.

Derivative instruments used by Onyx involve, to varying degrees, elements of credit risk in the event a counterparty should default and market risk as the instruments are subject to rate and price fluctuations. Credit risk is managed through the use of credit standard guidelines, counterparty diversification, monitoring of counterparty financial condition and International Swap Dealers Association master netting agreements in place with all derivative counterparties.

Accounting for Derivatives and Hedging Activities

All derivatives are recognized on the balance sheet at their fair value. On the date that the Company enters into a derivative contract, it designates the derivative as a hedge of a forecasted transaction of the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a cash flow hedge). Changes in the fair value of a derivative that are highly effective and previously designated to qualify as a cash flow hedge to the extent that the hedge is effective, are recorded in other comprehensive income until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current-period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges or specific firm commitments or forecasted transactions. The Company also formally assesses (both at the hedge s inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not, or has ceased to be, highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(UNAUDITED)

The Company will discontinue hedge accounting prospectively when (1) it determines that the derivative is no longer highly effective in offsetting changes in the cash flows of a hedged item such as firm commitments or forecasted transactions; (2) it is no longer probable that the forecasted transaction will occur; (3) the derivative expires or is sold, terminated, or exercised; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

NOTE 6 NEW PRONOUNCEMENTS

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities A Replacement of FAS 125. This Statement replaces FAS 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities. It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of FAS 125 s provisions without reconsideration. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. Adoption of SFAS No. 140 did not have a material effect on the Company s financial statements.

In July 2001, the Financial Accounting Standards Board issued Statements on Financial Accounting Standards (SFAS) Nos. 141 (Business Combinations) and 142 (Goodwill and Other Intangible Assets). SFAS No. 141, among other things, eliminates the use of the pooling of interests method of accounting for business combinations. Under the provisions of SFAS No. 142 goodwill will no longer be amortized, but will be subject to a periodic test for impairment based upon fair values. SFAS No. 141 is effective for all business combinations initiated after June 30, 2001. SFAS No. 142 will be effective for the Company beginning January 1, 2002. The adoption of these statements is not expected to have a material effect on the Company s financial statements.

In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This Statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets, and supersedes FAS-121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of. The statement also supersedes APB-30, Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business and Extraordinary, Unusual and Infrequently Occurring Events and Transactions. This Statement is effective for financial statements issued for fiscal years beginning after December 15, 2001. At present, the Company believes that FAS-144 will not have an effect on its consolidated financial statements.

NOTE 7 CONTINGENCIES

The Company is party to various legal proceedings similar to actions brought against other companies in the motor vehicle finance and other industries, which are or may or may not be covered under insurance policies it holds. The Company vigorously defends such proceedings; however, there is no assurance as to the results. Based upon information presently available, the Company believes that the final outcome of all such proceedings should not have a material adverse effect upon the Company s results of operations, cash flows or financial condition.

NOTE 8 SUBSEQUENT EVENTS

During the fourth quarter of 2001, the Company securitized $400 million in Contracts.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Onyx Acceptance Corporation (Onyx or the Company) is a specialized consumer finance company engaged in the purchase, securitization and servicing of Contracts originated by franchised and select independent automobile dealerships. The Company focuses its efforts on acquiring Contracts collateralized by late model used and, to a lesser extent, new motor vehicles, entered into with purchasers whom the Company believes have an acceptable credit profile.

The Company generates revenues primarily through the purchase, origination, warehousing, subsequent securitization and ongoing servicing of Contracts. The Company earns net interest income on Contracts held during the warehousing period. Upon the securitization and sale of Contracts, the Company recognizes a gain on sale of Contracts, receives future excess cash flows generated by owner and grantor trusts, and earns fees from servicing the securitized Contracts.

Prior to securitizing Contracts, the Company earns interest income on its Contracts, pays interest on funds used to purchase the Contracts and absorbs any credit losses. After securitization, the net earnings are recorded as retained interest income, which is a component of interest income.

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RESULTS OF OPERATIONS

NET INTEREST INCOME

Net interest income consists primarily of the difference between the finance revenue earned on Contracts held on the balance sheet during the warehousing period and the interest costs associated with the Company s borrowings to purchase such Contracts.

Net interest income totaled approximately $7.5 million and $16.0 million for the three and nine-month period ended September 30, 2001 compared to $284.0 thousand and $5.3 million for the same periods in 2000. The increase in net interest income was primarily due to the adoption of Emerging Issues Task Force (EITF) 99-20 and a reduction in interest expense related to the Company s warehouse financing line of credit as a result of declining market interest rates. EITF 99-20 requires that the Company recognize income from its retained interest in securitized assets on a level yield accrual method over the remaining estimated life of the corresponding asset. Prior to EITF 99-20, the Company recognized income on its credit enhancement assets as a component of service fee income.

GAIN ON SALE OF CONTRACTS

The Company recorded a gain on sale of Contracts of $6.6 million and $26.2 million for the three and nine-month periods ended September 30, 2001, compared to $12.1 million and $38.8 million for the same periods in 2000. Over the past year, management has targeted higher credit-worthy borrowers resulting in a reduction in the weighted average net interest spread for securitizations executed during 2001. However, in light of the general economic conditions the nation is experiencing, management estimates that credit losses will occur at rates similar to the Company's historical experience. These factors are the principal reasons underlying the reduction in the gain on sale of Contracts from 2000 to 2001. The net interest rate spread is the difference between the weighted average Contract rate of the securitized assets, and the weighted average investor rate inclusive of all costs related to the sale. The net interest rate spread is also affected by product mix, general market conditions and overall market interest rates. For securitizations executed during the nine-month period in 2000, the weighted average net interest rate spread before issuance costs and losses was 5.38%; this rate declined to 4.87% for the same period in 2001. In addition, a reduction in Contracts securitized, from $1.32 billion during the nine-month period in 2000, to $1.2 billion for the same period in 2001, contributed to the decline in gain on sale of Contracts.

SERVICE FEE INCOME

Service fee income includes contractual servicing income and other fee income. Contractual service fee income is earned at a rate of 1% per annum on the outstanding balance of Contracts securitized. Other fee income consists primarily of documentation fees, late charges and deferment fees and is dependent on the number of Contracts originated and the size of the serviced portfolio. Increased competition may also affect the amount of other fee income that the Company may earn when originating or servicing Contracts.

Service fee income decreased to $12.4 million during the third quarter of 2001, versus $13.9 million for the same period in 2000. This decrease is principally due to the adoption of EITF 99-20, which requires that the Company recognize income from its retained interest in securitized assets on a level yield accrual method over the remaining estimated life of the corresponding asset. Prior to EITF 99-20, the Company recognized income on its credit enhancement assets as a component of service fee income. Service fee income for the nine-month period ending September 30, 2001 was $38.2 million compared to $32.8 million for the same period in 2000. These increases are due to higher amounts of service fees as a result of the growth of the average serviced portfolio. The average serviced portfolio increased to $2.8 billion for the nine months ended September 30, 2001, compared to $2.4 billion for the same period in 2000. In addition, the adoption date of EITF 99-20, which was not retroactive, was April 1, 2001, leaving the first quarter of service fee income to be recorded under the previous accounting standards.

PROVISION FOR CREDIT LOSSES

The Company maintains an allowance for credit losses to cover anticipated losses for Contracts held for sale. The allowance for credit losses is increased by adjusting the provision for credit losses to cover additional Contracts originated and increases in loss estimates and decreased by actual losses on the Contracts held for sale or by the reduction of the amount of Contracts held for sale. The level of the allowance is based principally on the outstanding balance of Contracts held for sale and the historical loss trends for the period of time the Contracts are held before being sold in a securitization. When the Company sells Contracts in a securitization transaction, it reduces its allowance for credit losses and factors probable losses into its calculation of gain on sale. The Company believes that the allowance for credit losses is currently adequate to absorb probable losses. The provision for credit losses totaled $502 thousand and $966 thousand for the three and nine-month periods ended September 30, 2001, compared to ($73) thousand and

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$645 thousand for the same periods in 2000. The negative provision for the third quarter of 2000 was caused by the reduction in Contracts held for sale. The increase in provision for both the quarter and nine-month period ending September 30, 2001 reflects a higher average Contract balance held for sale and an increase in net losses versus the same periods in 2000. Contracts held for sale decreased to $164.9 million as of September 30, 2000 from $236.6 million as of June 30, 2000. Provision for credit losses consists of net credit losses incurred during the warehousing period plus future provision for losses reserved against the net changes in Contracts held for sale during the period. Net credit losses were $306 thousand and $766 thousand during the three and nine-month periods ended September 30, 2001, compared to $329 thousand and $1.0 million for the same periods in 2000. The reduction in credit losses reflects management s decision to target higher credit-worthy borrowers beginning the fourth quarter of 2000.

OPERATING EXPENSES

Total operating expenses were $22.0 million or 3.08% of the average serviced portfolio for the three months ended September 30, 2001 compared to $22.0 million or 3.45% of the average serviced portfolio for the same period in 2000. For the nine months ended September 30, 2001, total operating expenses were $67.7 million or 3.22% of the average serviced portfolio, versus $63.9 million or 3.55% of the average serviced portfolio for the nine months ended September 30, 2000. Operating expenses for the quarter remained stable as a result of renegotiated service contracts with the Company s long distance telephone carriers and the successful conversion of the Company s loan and collection processes to an in-house system during the third quarter. The dollar increase in total operating expenses for the nine-month period is primarily attributable to an increase in the average serviced portfolio for the period. The average serviced portfolio increased to $2.8 billion for the nine months ended September 30, 2001 from $2.4 billion for the same period in 2000, an increase of approximately 17%.

The Company incurred salary and benefit expenses of $13.2 million for the three months ended September 30, 2001, compared to $11.3 million for the same period in 2000. For the nine months ended September 30, 2001 total salary and benefit expenses were $39.9 million versus $35.4 million for the same period in 2000. The dollar increase for both periods is attributable to the incremental staffing requirements related to the growth of the serviced portfolio. Salary and benefit expense as a percent of the average serviced portfolio were 1.9% for both the three and nine-month periods ending September 30, 2001, compared to 1.8% and 2.0% for the same periods in 2000, respectively.

System and servicing expenses declined to $476 thousand for the quarter ended September 30, 2001, compared to $1.3 million for the same period in 2000. For the nine months ended September 30, 2001, total system and servicing expenses declined to $3.6 million, compared to $4.7 million for the same period in 2000. These reductions reflect the renegotiation of several contracts with the Company s major service providers and the successful conversion of the Company s loan accounting and collection processes to an in-house system.

Telephone and data line charges declined to $1.2 million from $1.5 million for the third quarter of 2001 and 2000 respectively. For the nine months ended September 30, 2001, total telephone and data line charges were $3.7 million, versus $4.7 million for the same period in 2000. Although these charges generally increase with the growth of the serviced portfolio, the reduction between 2001 and 2000 was primarily due to renegotiated contracts for long distance rates with certain carriers. Assuming no additional reduction in long distance rates, the Company expects these charges to increase with the continued growth of the serviced portfolio.

Depreciation expense remained relatively stable at $1.1 million and $3.6 million for the three and nine-month periods ending September 30, 2001, compared to $1.2 million and $3.2 million for the same periods in 2000. General and administrative expenses decreased slightly to $6.0 million for the three months ended September 30, 2001, compared to $6.6 million for the same period in 2000. For the nine months ended September 30, 2001 and 2000, general and administrative expenses were $17.0 million and $16.3 million, respectively. Higher expenses are primarily due to the growth of the average serviced portfolio.

INCOME TAXES

The combined effective tax rates for the Company's federal and state returns filed for the nine-month periods ending September, 2001 and September 2000 were 40.1% and 41.5%, respectively.

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FINANCIAL CONDITION

CONTRACTS HELD FOR SALE

Contracts held for sale totaled $207.5 million at September 30, 2001, compared to $173.8 million at December 31, 2000. The balance in the held for sale portfolio is largely dependent upon the timing of the origination and securitization of Contracts. The Company completed securitization transactions of $400.0 million during the first, second and third quarters of 2001. The Company plans to continue to securitize Contracts on a regular basis.

The following table illustrates the changes in the Company s Contract acquisition volume, securitization activity and servicing portfolio during the past five fiscal quarters:

SELECTED QUARTERLY FINANCIAL INFORMATION

	FOR THE QUARTERS ENDED				
	SEPT. 30, 2000	**DEC. 31, 2000**	**MAR. 31, 2001**	**JUNE 30, 2001**	**SEPT. 30, 2001**
	(DOLLARS IN THOUSANDS)				
Contracts purchased during period	$ 367,636	$ 401,181	$ 430,524	$ 379,595	$ 430,940
Average monthly volume during period	122,545	133,727	143,508	126,531	143,646
Gain on sale of Contracts	12,066	6,217	9,319	10,257	6,591
Contracts securitized during period	440,000	400,000	400,000	400,000	400,000
Servicing portfolio at period end	2,584,152	2,690,606	2,784,411	2,807,181	2,876,986

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ASSET QUALITY

The Company monitors and attempts to minimize delinquencies and losses through timely collections and the use of predictive dialing and other systems. At September 30, 2001, sixty plus day delinquencies represented 1.11% of the amount of Contracts in its serviced portfolio compared to 1.48% at December 31, 2000. Annualized net charge-offs as a percentage of the average serviced portfolio were 2.64% for the quarter ended September 30, 2001, compared to 2.20% for the same period in 2000.

Off balance sheet reserves at September 30, 2001 were 4.4%, compared to 4.6% at December 31, 2000. Off balance sheet reserves are those reserves established and maintained on Contracts sold to the grantor and owner trusts in connection with securitizations.

DELINQUENCY EXPERIENCE OF SERVICED PORTFOLIO

	SEPTEMBER 30, 2001		DECEMBER 31, 2000	
	AMOUNT	NO.	AMOUNT	NO.
	(DOLLARS IN THOUSANDS)			
Serviced portfolio	$2,876,986	288,822	$2,690,606	269,372
Delinquencies(1)(2)				
60 89 days	$ 17,730	2,062	$ 23,085	2,285
90+ days	14,168	1,624	16,748	1,749
Total	$ 31,898	3,686	$ 39,833	4,034
Total delinquencies as a percent of Serviced portfolio	1.11%	1.28%	1.48%	1.50%

(1) Delinquencies include principal amounts only, net of repossessed inventory and accounts in bankruptcy. Delinquent sixty plus day repossessed inventory as a percent of the serviced portfolio was 0.63% and 0.80% at September 30, 2001 and December 31, 2000, respectively. Delinquent sixty plus day Contracts in bankruptcy as a percent of the serviced portfolio were 0.77% and 0.41% at September 30, 2001 and December 31, 2000, respectively.

(2) The period of delinquency is based on the number of days payments are contractually past due.

LOAN LOSS EXPERIENCE OF SERVICING PORTFOLIO

	FOR THE THREE MONTHS ENDED SEPTEMBER 30,		FOR THE NINE MONTHS ENDED SEPTEMBER 30,	
	2001	2000	2001	2000
	(DOLLARS IN THOUSANDS)			
Period end Contracts outstanding	$2,876,986	$2,584,152	$2,876,986	$2,584,152
Average servicing portfolio(1)	$2,850,260	$2,539,409	$2,801,049	$2,397,770
Number of gross charge-offs	3,197	2,543	9,813	7,455
Gross charge-offs	$ 22,100	$ 16,259	$ 65,329	$ 47,209
Net charge-offs(2)	$ 18,835	$ 13,992	$ 55,950	$ 40,483
Annualized net charge-offs as a percent of average Serviced portfolio	2.64%	2.20%	2.66%	2.25%

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(1) Average is based on daily balances.

(2) Net charge-offs are gross charge-offs minus recoveries on Contracts previously charged off.

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THE FOLLOWING TABLE ILLUSTRATES THE MONTHLY CUMULATIVE LOSS PERFORMANCE OF EACH OF THE SECURITIZED POOLS OUTSTANDING FOR THE PERIOD FROM THE DATE OF SECURITIZATION THROUGH SEPTEMBER 30, 2001:

MONTH	97-2	97-3	97-4	98-1	98-A	98-B	98-C	99-A	99-B	99-C	99-D	00-A	00-B	00-C	00-D	01-A	01-B	01-C
1	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2	0.00%	0.00%	0.00%	0.01%	0.01%	0.00%	0.02%	0.00%	0.00%	0.01%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
3	0.02%	0.02%	0.01%	0.02%	0.03%	0.02%	0.02%	0.02%	0.03%	0.03%	0.01%	0.02%	0.02%	0.01%	0.00%	0.00%	0.01%	0.00%
4	0.07%	0.09%	0.04%	0.08%	0.07%	0.08%	0.04%	0.05%	0.07%	0.06%	0.04%	0.04%	0.04%	0.03%	0.02%	0.02%	0.03%	
5	0.22%	0.13%	0.11%	0.14%	0.14%	0.19%	0.15%	0.11%	0.14%	0.16%	0.09%	0.11%	0.10%	0.06%	0.07%	0.07%	0.10%	
6	0.32%	0.24%	0.20%	0.24%	0.23%	0.33%	0.27%	0.21%	0.27%	0.28%	0.15%	0.18%	0.17%	0.11%	0.15%	0.12%		
7	0.59%	0.36%	0.28%	0.40%	0.37%	0.45%	0.46%	0.35%	0.43%	0.47%	0.24%	0.37%	0.30%	0.26%	0.26%	0.20%		
8	0.80%	0.47%	0.43%	0.53%	0.42%	0.61%	0.57%	0.49%	0.60%	0.64%	0.43%	0.63%	0.44%	0.41%	0.39%	0.31%		
9	0.91%	0.62%	0.55%	0.68%	0.51%	0.82%	0.74%	0.63%	0.85%	0.83%	0.59%	0.87%	0.67%	0.65%	0.50%			
10	1.07%	0.73%	0.72%	0.85%	0.70%	0.95%	0.94%	0.81%	1.07%	1.09%	0.76%	1.05%	0.90%	0.85%	0.65%			
11	1.26%	0.81%	0.87%	1.04%	0.85%	1.10%	1.12%	1.04%	1.34%	1.31%	0.99%	1.27%	1.11%	1.08%	0.85%			
12	1.42%	0.94%	0.95%	1.20%	1.01%	1.20%	1.30%	1.29%	1.56%	1.47%	1.20%	1.59%	1.38%	1.29%				
13	1.58%	1.10%	1.08%	1.33%	1.17%	1.36%	1.54%	1.49%	1.79%	1.62%	1.41%	1.82%	1.57%	1.42%				
14	1.68%	1.23%	1.19%	1.46%	1.37%	1.48%	1.73%	1.72%	1.90%	1.77%	1.52%	2.03%	1.84%	1.65%				
15	1.80%	1.38%	1.36%	1.61%	1.48%	1.64%	1.90%	1.90%	2.08%	2.00%	1.70%	2.25%	2.08%	1.93%				
16	1.97%	1.58%	1.42%	1.71%	1.59%	1.89%	2.10%	2.10%	2.23%	2.08%	2.00%	2.48%	2.26%					
17	2.10%	1.68%	1.52%															