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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**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, 2000**

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

**Commission file number: 1-14116**

**CONSUMER PORTFOLIO SERVICES, INC.**

(Exact name of registrant as specified in its charter)

**California**  
(State or other jurisdiction of  
incorporation or organization)

**33-0459135**  
(I.R.S. Employer  
Identification No.)

**16355 Laguna Canyon Road, Irvine, California**  
(Address of principal executive offices)

**92618**  
(Zip Code)

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

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

**Title of each class:**

**Rising interest subordinated redeemable Securities due 2006 10.50% participating equity notes due 2004**

**Name of each exchange on which registered:**

**New York Stock Exchange**

**Securities registered pursuant to section 12(g) of the Act:**

**Common Stock, No Par Value**

Indicate by check mark whether the registrant (1) 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 if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-K 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.

The aggregate market value on March 22, 2001 (based on the \$1.75 per share closing price on the Nasdaq Stock Market on that date) of the voting stock beneficially held by non-affiliates of the registrant was \$23,223,482. The number of shares of the registrant's Common Stock outstanding on March 22, 2001, was 19,537,440.

DOCUMENTS INCORPORATED BY REFERENCE

The registrant's proxy statement for its 2001 annual meeting of shareholders is incorporated by reference into Part III of this report.

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## PART I

### Item 1. *Business*

#### General

Consumer Portfolio Services, Inc. ("CPS," and together with its subsidiaries, the "Company") is a consumer finance company specializing in the business of purchasing, selling and servicing retail automobile installment contracts ("Contracts") originated by licensed motor vehicle dealers ("Dealers") in the sale of new and used automobiles, light trucks and passenger vans. Through its purchases, the Company provides indirect financing to Dealer customers with limited credit histories, low incomes or past credit problems ("Sub-Prime Customers"). The Company serves as an alternative source of financing for Dealers, allowing sales to customers who otherwise might not be able to obtain financing. The Company does not lend money directly to consumers. Rather, it purchases installment Contracts from Dealers.

CPS was incorporated and began its operations in 1991. From inception through December 31, 2000 the Company has purchased approximately \$3.4 billion of Contracts, and as of December 31, 2000, had an outstanding servicing portfolio of approximately \$412 million. The Company makes the decision to purchase Contracts exclusively from its headquarters location. The Company services the Contracts from two regional centers, one in its California headquarters, and the other in Virginia.

#### The Market We Serve

The Company's automobile financing programs are designed to serve customers who generally would not qualify for automobile financing from traditional sources, such as commercial banks, credit unions and the captive finance companies affiliated with major automobile manufacturers. Such customers ("Sub-Prime Customers") generally have limited credit histories, low incomes or past credit problems, and are therefore often unable to obtain credit from traditional sources of automobile financing. (The terms "prime" and "sub-prime" reflect the Company's categorization of customers and bear no relationship to the prime rate of interest or persons who are able to borrow at that rate.) Because the Company serves customers who are unable to meet the credit standards imposed by most traditional automobile financing sources, the Company generally receives interest at rates higher than those charged by traditional automobile financing sources. The Company also sustains a higher level of credit losses than traditional automobile financing sources since the Company provides financing in a relatively high risk market.

#### Marketing

The Company directs its marketing efforts to Dealers, rather than to consumers. As of December 31, 2000, the Company was a party to its standard form dealer agreements ("Dealer Agreements") with 4,504 Dealers. Approximately 99% of these Dealers are franchised new car dealers that sell both new and used cars and the remainder are independent used car dealers. For the year ended December 31, 2000, approximately 83% of the Contracts purchased by the Company consisted of financing for used cars and the remaining 17% for new cars, as compared to 85% new and 15% used in the year ended December 31, 1999.

The Company establishes relationships with Dealers through Company representatives who contact a prospective Dealer to explain the Company's Contract purchase programs, and who thereafter provide Dealer training and support services. As of December 31, 2000, the Company had 64 representatives, 62 of whom were employees and 2 of whom were independent. The representatives are contractually obligated to represent the Company's financing program exclusively. The Company's representatives present the Dealer with a marketing package, which includes the Company's promotional material containing the terms offered by the Company for the purchase of Contracts, a copy of the Company's standard-form Dealer Agreement, examples of monthly reports, and required documentation relating to Contracts. Marketing representatives have no authority relating to the decision to purchase Contracts from Dealers.

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Most of the Dealers under contract with CPS regularly submit Contracts to the Company for purchase, although they are under no obligation to submit any Contracts to the Company, nor is the Company obligated to purchase any Contracts. During the year ended December 31, 2000, no Dealer accounted for more than 1.0% of the total number of Contracts purchased by the Company. The following table sets forth the geographical sources of the Contracts purchased by the Company (based on the addresses of the customers as stated on the Company's records) during the years ended December 31, 2000 and 1999:

	<b>Contracts Purchased During The Year Ended</b>			
	<b>December 31, 2000</b>		<b>December 31, 1999</b>	
	<b>Number</b>	<b>Percent</b>	<b>Number</b>	<b>Percent</b>
California .....	5,251	12.8%	4,446	15.2%
Texas .....	5,023	12.2%	2,383	8.1%
North Carolina .....	3,691	9.0%	2,298	7.9%
Florida .....	3,437	8.4%	1,856	6.3%
Louisiana .....	3,413	8.3%	1,728	5.9%
Alabama .....	2,631	6.4%	1,942	6.6%
Pennsylvania .....	2,217	5.4%	2,336	8.0%
Michigan .....	2,042	5.0%	1,915	6.5%
South Carolina .....	1,807	4.4%	884	3.0%
New York .....	1,375	3.3%	928	3.2%
Illinois .....	1,359	3.3%	615	2.1%
Maryland .....	965	2.3%	733	2.5%
Ohio .....	958	2.3%	629	2.1%
New Jersey .....	907	2.2%	514	1.8%
Virginia .....	880	2.1%	512	1.7%
Other States .....	<u>5,112</u>	12.4%	<u>5,548</u>	19.0%
Total .....	<u>41,068</u>	100.0%	<u>29,267</u>	100.0%

### **Origination of Contracts**

*Dealer Origination.* 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. The Company believes the Dealer's decision to finance the automobile purchase with the Company, rather than other financing sources, is based primarily on the monthly payment that will be offered to the automobile buyer, the discounted purchase price offered for the Contract, the timeliness, consistency and predictability of response, the cash resources of the financing source, and any conditions to purchase.

Upon receipt of an application from a Dealer, the Company's administrative personnel order a credit report to document the buyer's credit history. If, upon review by a Company loan officer, it is determined that the application meets the Company's underwriting criteria, or would meet such criteria with modification, the Company requests and reviews further information and supporting documentation and, ultimately, decides whether to purchase the Contract. When presented with an application, the Company attempts to notify the Dealer within four hours as to whether it intends to purchase such Contract.

The actual agreement for purchase of the vehicle ("Contract") is prepared by the Dealer. The Dealer also arranges for recording the Company's lien on the vehicle. After the appropriate documents are signed by the Dealer and the customer, the Dealer sells the Contract to the Company. The Company currently sells immediately a portion of the Contracts that it purchases, and holds the remainder for its own account. In either case, the customer then receives monthly billing statements.

The Company purchases Contracts from Dealers at a price generally equal to the total amount financed under the Contracts, reduced by an acquisition fee ranging from zero to \$1,595 for each Contract purchased. The fees vary based on the perceived credit risk and, in some cases, the interest rate on the Contract. For the years ended December 31, 2000, 1999 and 1998, the average amount charged per Contract purchased was \$469, \$336 and \$418, respectively, or 3.17%, 2.32% and 3.24%, respectively, of the amount financed. In addition, during 1998 the Company began purchasing certain Contracts of higher credit quality for which the Company pays a fee to the Dealer. During 2000, 1999 and 1998, respectively, the Company purchased 2,104, 2,161 and 1,583 of these Contracts, representing approximately 5.1%, 7.4% and 1.9% of all Contracts purchased. The average fee paid to Dealers on these Contracts was \$595, \$568 and \$531, respectively.

The Company attempts to control misrepresentation regarding the customer's credit worthiness by carefully screening the Contracts it purchases, 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, the Company may require the Dealer to repurchase any Contract in the event that the Dealer breaches its representations or warranties. There can be no assurance, however, that any Dealer will have the financial resources to satisfy its repurchase obligations to the Company.

*Objective Contract Purchase Criteria.* To be eligible for purchase by the Company, a Contract must have been originated by a Dealer that has entered into a Dealer Agreement to sell Contracts to the Company. The Contracts must be secured by a first priority lien on a new or used automobile, light truck or passenger van and must meet the Company's underwriting criteria. In addition, each Contract requires the customer to maintain physical damage insurance covering the financed vehicle and naming the Company as a loss payee. The Company or any purchaser of the Contract from the Company 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 Contract and is unable to pay for repairs to or replacement of the vehicle or is otherwise unable to fulfill his or her obligations under the Contract.

The Company believes that its objective underwriting criteria enable it to evaluate effectively the creditworthiness of Sub-Prime Customers and the adequacy of the financed vehicle as security for a Contract. These 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 Contract in relation to the value of the vehicle; customer income level, job and residence stability, credit history and debt serviceability; and other factors. Specifically, the Company's guidelines limit the maximum principal amount of a purchased Contract to 115% of wholesale book value in the case of used vehicles or to 110% 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 credit life or disability policy. The Company does not finance vehicles that are more than seven model years old or have in excess of 85,000 miles. Under most CPS programs, the maximum term of a purchased Contract is 60 months; a shorter maximum term may be applied based on the year and mileage of the vehicle, and contracts with terms up to 72 months may be purchased if the customer is among the more creditworthy of CPS's obligors and the vehicle is not more than three model years old and has less than 30,000 miles. Contract purchase criteria are subject to change from time to time as circumstances may warrant. Upon receiving this information with the customer's application, the Company's underwriters verify the customer's employment, residency, insurance and credit information provided by the customer by contacting various parties noted on the customer's application, credit information bureaus and other sources. In addition, prior to purchasing a Contract, CPS contacts each customer by telephone to confirm that the Customer understands and agrees to the terms of the related Contract.

*Credit Scoring.* The Company has used a proprietary scoring model to assign to each Contract a "credit score" at the time the application is received from the Dealer and the customer's credit information is retrieved from the credit reporting agencies. The credit score is based on a variety of parameters, such as the customer's job and residence stability, the amount of the down payment, and the age and mileage of the vehicle. The Company has developed the credit score as a means of improving its allocation of credit evaluation resources, and managing the risk inherent in the sub-prime market.

*Characteristics of Contracts.* All of the Contracts purchased by the Company are fully amortizing and provide for level payments over the term of the Contract. The average original principal amount financed under Contracts purchased in the year ended December 31, 2000 was approximately \$14,780, with an average original term of approximately 62 months and an average down payment of 13.2%. Based on information contained in customer

applications, for this twelve-month period, the retail purchase price of the related automobiles averaged \$15,064 (which excludes tax and license fees, and any additional costs such as a maintenance contract), the average age of the vehicle at the time the Contract was purchased was 3 years, and the Company's customers averaged approximately 37 years of age, with approximately \$35,693 in average annual household income and an average of 4.5 years' history with his or her current employer.

*All Contracts may be prepaid at any time without penalty.* In the event a customer elects to prepay a Contract in full, the payoff amount is calculated by deducting the unearned interest from the Contract balance, in the case of a pre-computed Contract, or by adding accrued interest to the Contract balance, in the case of a simple interest Contract.

Each Contract purchased by the Company prohibits the sale or transfer of the financed vehicle without the Company's consent and allows for the acceleration of the maturity of a Contract upon a sale or transfer without such consent. In most circumstances, the Company will not consent to a sale or transfer of a financed vehicle unless the related Contract is prepaid in full.

*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 the Company as secured party with respect to the vehicle, was effected at the time of sale of the related Contract to the Company, and that all necessary steps have been taken to obtain a perfected first priority security interest in each financed vehicle in favor of the Company under the laws of the state in which the financed vehicle is registered. If a Dealer or the Company, because of clerical error or otherwise, has failed to take such action in a timely manner, or to maintain such interest with respect to a financed vehicle, neither the Company nor any purchaser of the related Contract from the Company would have a perfected security interest in the financed vehicle and its security interest may be subordinate to the interest of, among others, subsequent purchasers of the financed vehicle, holders of perfected security interests and a trustee in bankruptcy of the customer. The security interest of the Company or the purchaser of a Contract may also be subordinate to the interests of third parties if the interest is not perfected due to administrative error by state recording officials. Moreover, fraud or forgery could render a Contract unenforceable. In such events, the Company could suffer a loss with respect to the related Contract. In the event the Company suffers such a loss, it will generally have recourse against the Dealer from which it purchased the Contract. This recourse will be unsecured, and there can be no assurance that any particular Dealer will satisfy any such repurchase obligations to the Company.

### **Servicing of Contracts**

*General.* The Company's servicing activities consist of 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; and generally monitoring each Contract and any related collateral.

*Collection Procedures.* The Company believes that its ability to monitor performance and collect payments owed from Sub-Prime Customers is primarily a function of its collection approach and support systems. The Company believes that if payment problems are identified early and the Company's collection staff works closely with customers to address these problems, it is possible to correct many of them before they deteriorate further. To this end, the Company utilizes 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 its collection activities, the Company maintains a computerized collection system specifically designed to service automobile installment sale contracts with Sub-Prime Customers and similar consumer obligations.

With the aid of its high penetration auto dialer, the Company typically attempts to make telephonic contact with delinquent customers on the sixth day after their monthly payment due date. Using coded instructions from a collection supervisor, the automatic dialer will attempt to contact customers based on their physical location, state of delinquency, size of balance or other parameters. If the automatic dialer obtains a "no-answer" or a busy signal, it records the attempt on the customer's record and moves on to the next call. If a live voice answers the automatic

dialer's call, the call is transferred to a waiting collector at the same time that the customer's pertinent information is simultaneously displayed on the collector's workstation. The collector then inquires of the customer the reason for the delinquency and when the Company can expect to receive the payment. The collector will attempt to get the customer to make a promise for the delinquent 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 pending 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 automatic dialing 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 45th and 90th day past the customer's payment due date, but could occur sooner or later, depending on the specific circumstances.

If CPS elects to repossess the vehicle, it assigns 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 reposessor delivers it to a wholesale auto auction, where it is kept until sold, usually within 30 days of the repossession. The UCC and other state laws regulate repossession sales by requiring that the secured party provide the customer with reasonable notice of the date, time and place of any public sale of the collateral, the date after which any private sale of the collateral may be held and of the customer's right to redeem the financed vehicle prior to any such sale and by providing that any such sale be conducted in a commercially reasonable manner. Financed vehicles repossessed generally are resold by the Company through unaffiliated automobile auctions, which are attended principally by car dealers. Net liquidation proceeds are applied to the customer's outstanding obligation under the Contract.

Under the UCC and other laws applicable in most states, a creditor is entitled to obtain a deficiency judgment from a customer for any deficiency on repossession and resale of the motor vehicle securing the unpaid balance of such customer's Contract. However, some states impose prohibitions or limitations on deficiency judgments. When obtained, deficiency judgments are entered against defaulting individuals who may have little capital or income. Therefore, in many cases, it may not be useful to seek a deficiency judgment against a customer or, if one is obtained, it may be settled at a significant discount.

## Credit Experience

The Company's financial results are dependent on the performance of the Contracts in which it retains an ownership interest. The tables below document the delinquency, repossession and net credit loss experience of all Contracts that the Company was servicing as of the respective dates shown.

### Delinquency Experience(1)

	December 31, 2000		December 31, 1999		December 31, 1998	
	Number of Contracts	Amount	Number of Contracts	Amount	Number of Contracts	Amount
Gross servicing portfolio(1) .....	60,178	\$ 427,734	92,388	\$ 868,797	141,396	\$ 1,674,417
Period of delinquency(2)						
31-60 days.....	2,319	16,778	2,781	26,204	4,202	48,324
61-90 days.....	683	4,983	1,130	11,226	1,869	22,335
91+ days.....	418	3,148	652	6,997	1,694	20,096
Total delinquencies(2).....	3,420	24,909	4,563	44,427	7,765	90,755
Amount in repossession(3).....	1,106	8,302	3,424	28,896	2,961	32,772
Total delinquencies and amount in repossession(2).....	4,526	\$ 33,211	7,987	\$ 73,323	10,726	\$ 123,527
Delinquencies as a percent of gross servicing portfolio.....	5.7%	5.8%	4.9%	5.1%	5.5%	5.4%
Total delinquencies and amount in repossession as a percent of gross servicing portfolio.....	7.5%	7.8%	8.7%	8.4%	7.6%	7.4%

(1) All amounts and percentages are based on the full amount remaining to be repaid on each Contract, including, for pre-computed Contracts, any unearned finance charges. The information in the table represents the principal

amount of all Contracts purchased by the Company, including Contracts subsequently sold by the Company, which it continues to service.

- (2) The Company considers a 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. Contracts less than 31 days delinquent are not included.
- (3) Amount in repossession represents financed vehicles that have been repossessed but not yet liquidated.

#### Net Charge-Off Experience(1)

	Year Ended December 31,		
	2000	1999	1998
	(Dollars in thousands)		
Average servicing portfolio outstanding.....	\$ 578,200	\$ 1,223,238	\$ 1,300,519
Net charge-offs as a percent of average servicing portfolio(2)(3).....	11.2%	9.2%	6.5%

- (1) All amounts and percentages are based on the principal amount scheduled to be paid on each Contract. The information in the table represents all Contracts serviced by the Company.
- (2) Net charge-offs include the remaining principal balance, after the application of the net proceeds from the liquidation of the vehicle (excluding accrued and unpaid interest).
- (3) The increase in net charge-offs as a percent of the average servicing portfolio is primarily due to the decrease in the servicing portfolio for the year ended December 31, 2000, compared to the prior year.

#### Flow Purchase Program

From May 1999 through the date of this report, the Company has purchased Contracts primarily for immediate and outright resale to non-affiliated third parties. The Company sells such Contracts for a mark-up above what the Company pays the Dealer. In such sales, the Company makes certain representations and warranties to the purchasers, normal in the industry, which relate primarily to the legality of the sale of the underlying motor vehicle and to the validity of the security interest that is being conveyed to the purchaser. These representations and warranties are generally similar to the representations and warranties given by the originating Dealer to the Company. In the event of a breach of such representations or warranties, the Company may incur liabilities in favor of the purchaser(s) of the Contracts and there can be no assurance that the Company would be able to recover, in turn, against the originating Dealer(s).

#### Liquidation of Non-securitized Portfolio

From June 1994 through November 1998, substantially all Contracts that the Company purchased were sold in securitization transactions, as described below. In March 1999 the Company learned that it would not be able to close a securitization transaction for an indefinite period. The Company's "warehouse" lines of credit, under which the Company had drawn funds to acquire Contracts, by their terms set a limit on how long any Contract could be considered eligible collateral thereunder. Because the Company was unable to sell Contracts in a securitization transaction, those time limits were exceeded, and the Company fell into default on those lines of credit. In order to repay the outstanding indebtedness the Company embarked on a program of selling outright, to non-affiliated third parties, substantially all of such Contracts. A total of approximately \$318.0 million of Contracts were sold from June 1999 through September 1999, yielding sufficient proceeds to repay all of the warehouse indebtedness. All of such sales were at prices less than the Company's acquisition cost of such Contracts; accordingly, the Company recorded a net loss in the approximate aggregate amount of \$15.2 million on such sales. The Company has no intention or expectation of again selling quantities of Contracts at less than their acquisition cost.

#### Securitization and Sale of Contracts

The Company currently purchases Contracts (i) for immediate and outright resale to non-affiliated third parties, and (ii) to hold pending resale in securitization transactions. The Company has not sold Contracts in a securitization transaction since December 1998, and there can be no assurance that such future transactions will occur.

In a securitization sale, the Company is required to make certain representations and warranties, which are generally similar to the representations and warranties made by Dealers in connection with the Company's purchase of the Contracts. If the Company breaches any of its representations or warranties to a purchaser of the Contracts, the Company will be obligated to repurchase the Contract from such purchaser at a price equal to such purchaser's purchase price less the related cash securitization reserve and any payments received by such purchaser on the Contract. The Company may then be entitled under the terms of its Dealer Agreement to require the selling Dealer to repurchase the Contract at a price equal to the Company's purchase price, less any payments made by the customer. Subject to any recourse against Dealers, the Company will bear the risk of loss on repossession and resale of vehicles under Contracts repurchased by it.

Upon the sale of a portfolio of Contracts in a securitization transaction, the Company retains the obligation to service the Contracts, and receives a monthly fee for doing so. Among other services performed, the Company mails to obligors monthly billing statements directing them to mail payments on the Contracts to a lock-box account. The Company engages an independent lock-box processing agent to retrieve and process payments received in the lock-box account. This results in a daily deposit to the trust's bank account of the entire amount of each day's lock-box receipts and the simultaneous electronic data transfer to the Company of customer payment data records. Pursuant to the Servicing Agreements, the Company is required to deliver monthly reports to the trust reflecting all transaction activity with respect to the Contracts. The reports contain, among other information, a reconciliation of the change in the aggregate principal balance of the Contracts in the portfolio to the amounts deposited into the trust's bank account as reflected in the daily reports of the lock-box processing agent.

Pursuant to its securitization purchase commitments, the Company generally warrants that, to the best of the Company's knowledge, no such liens or claims are pending or threatened with respect to a financed vehicle, which may be or become prior to or equal with the lien of the related Contracts. In the event that any of the Company's representations or warranties proves to be incorrect, the trust would be entitled to require the Company to repurchase the Contract relating to such financed vehicle.

### **The Servicing Portfolio**

The Company currently services all Contracts that it owns, as well as those Contracts included in portfolios that it has sold to securitization trusts. The Company does not service Contracts that were acquired in its flow purchase program or that were sold in its Contract liquidation program. Pursuant to the Company's usual form of servicing agreement (the Company's servicing agreements with purchasers of portfolios of Contracts are collectively referred to as the "Servicing Agreements"), CPS is obligated to service all Contracts sold to the trusts in accordance with the Company's standard procedures. The Servicing Agreements generally provide that the Company will bear all costs and expenses incurred in connection with the management, administration and collection of the Contracts serviced. The Servicing Agreements also provide that the Company will take all actions necessary or reasonably requested by the investor to maintain perfection and priority of the trust's security interest in the financed vehicles.

The Company is entitled under most of the Servicing Agreements to receive a base monthly servicing fee of 2.0% per annum computed as a percentage of the declining outstanding principal balance of the non-defaulted Contracts in the portfolio. The Servicing Agreements also provide that the Company is entitled to receive certain other fees collected from customers. Each month, after payment of the Company's base monthly servicing fee and certain other fees, the trust receives the paid principal reduction of the Contracts in its portfolios and interest thereon at the fixed rate that was agreed when the Contracts were sold to the Trust. If, in any month, collections on the Contracts are insufficient to pay such amounts and any principal reduction due to charge-offs, the shortfall is satisfied from the "Spread Account" established in connection with the sale of the portfolio. The "Spread Account" is an account established at the time the Company sells a portfolio of Contracts, to provide security to the purchase of the portfolio. If collections on the Contracts exceed such amounts, the excess is utilized, first, to build up or replenish the Spread Account to the extent required, next, to cover deficiencies in Spread Accounts for other portfolios, and the balance, if any, constitutes excess cash flows, which are distributed to the Company.

Pursuant to the Servicing Agreements, the Company is generally required to charge off the balance of any Contract by the earlier of the end of the month in which the Contract becomes four scheduled installments past due or, in the case of repossessions, the month that the proceeds from the liquidation of the financed vehicle are received

by the Company or if the vehicle has been in repossession inventory for more than 90 days. In the case of a repossession, the amount of the charge-off is the difference between the outstanding principal balance of the defaulted Contract and the net repossession sale proceeds. In the event collections on the Contracts are not sufficient to pay to the holders of interests in the trust ("Investors") the entire principal balance of Contracts charged off during the month, the trustee draws on the related Spread Account to pay the Investors. The amount drawn would then have to be restored to the Spread Account from future collections on the Contracts remaining in the portfolio before the Company would again be entitled to receive excess cash. In addition, the Company would not be entitled to receive any further monthly servicing fees with respect to the defaulted Contracts. Subject to any recourse against the Company in the event of a breach of the Company's representations and warranties with respect to any Contracts and after any recourse to any insurer guarantees backing the Certificates, the Investors bear the risk of all charge-offs on the Contracts in excess of the Spread Account. The Investors' rights with respect to distributions from the Trusts are senior to the Company's rights. Accordingly, variation in performance of pools of Contracts affects the Company's ultimate realization of value derived from such Contracts.

The Servicing Agreements are terminable by the insurer of certain of the trust's obligations in the event of certain defaults by the Company and under certain other circumstances. As of December 31, 2000, 7 of the Company's 9 remaining securitized pools had incurred cumulative losses exceeding certain predetermined levels, which in turn has given the certificate insurer the right to terminate the Servicing Agreements with respect to all of the pools. To date, the certificate insurer has waived its right to terminate the Servicing Agreements.

### **Competition**

The automobile financing business is highly competitive. The Company competes with a number of national, local and regional finance companies with operations similar to those of the Company. 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 General Motors Acceptance Corporation, Ford Motor Credit Corporation, and Nissan Motors Acceptance Corporation. Many of the Company's competitors and potential competitors possess substantially greater financial, marketing, technical, personnel and other resources than the Company. Moreover, the Company's future profitability will be directly related to the availability and cost of its capital in relation to the availability and cost of capital to its competitors. The Company's 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 the Company. 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 is not offered by the Company.

The Company believes that the principal competitive factors affecting a Dealer's decision to offer Contracts for sale to a particular financing source are the purchase price offered for the Contracts, the reasonableness of the financing source's underwriting guidelines and documentation requests, the predictability and timeliness of purchases and the financial stability of the funding source. The Company believes that it can obtain from Dealers sufficient Contracts for purchase at attractive prices by consistently applying reasonable underwriting criteria and making timely purchases of qualifying Contracts.

### **Government Regulation**

Several 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 the extension of credit in consumer credit transactions. These laws mandate certain disclosures with respect to finance charges on Contracts and impose certain other restrictions on Dealers. In many states, a license is required to engage in the business of purchasing 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 motor vehicles 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 the Company and purchasers of Contracts from the Company. The Dealer Agreement contains representations by the Dealer that, as of the date of

assignment of Contracts, no such claims or defenses have been asserted or threatened with respect to the 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 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 to the Company. Certain of these laws also regulate the Company's servicing activities, including its methods of collection.

Although the Company believes that it is currently in material compliance with applicable statutes and regulations, there can be no assurance that the Company will be able to maintain such compliance. The past or future failure to comply with such statutes and regulations could have a material adverse effect upon the Company. Furthermore, the adoption of additional statutes and regulations, changes in the interpretation and enforcement of current statutes and regulations or the expansion of the Company's business into jurisdictions that have adopted more stringent regulatory requirements than those in which the Company currently conducts business could have a material adverse effect upon the Company. In addition, due to the consumer-oriented nature of the industry in which the Company operates 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 the Company or within the industry in connection with any such litigation could have a material adverse effect on the Company's financial condition, results of operations or liquidity. See "Legal Proceedings."

### **Alternative Marketing Programs**

From 1996 through 1998, the Company invested in a 80 percent-owned subsidiary, Samco Acceptance Corporation ("Samco"), which pursued a business strategy of purchasing Contracts from independent finance companies that had in turn purchased the Contracts from Dealers. The Contracts purchased from Samco showed consistently higher losses than Contracts purchased by CPS directly from Dealers. In December 1998, the Company ceased further investments in Samco, and Samco terminated all operations during the first quarter of 1999. The Company believes that any credit losses related to Samco-originated Contracts have been adequately reserved for, and that no material losses will result from Samco's terminated operations.

In May 1996, CPS formed LINC Acceptance Corp. ("LINC"), an 80 percent-owned subsidiary based in Norwalk, Connecticut. LINC offered the Company's sub-prime auto finance products to credit unions, banks and savings institutions ("Depository Institutions"). The Company believes that Depository Institutions do not generally make loans to Sub-Prime Customers, even though they may have relationships with Dealers and have Sub-Prime Customers.

During the second quarter of 1999, the Company ceased to provide additional funding to LINC in conjunction with the Company's plan to reduce the level of Contract purchases and thus to decrease its capital requirements. LINC thereupon ceased its operations. In November 1999 three former employees of LINC filed an involuntary Chapter 7 (liquidation) bankruptcy petition against LINC. See "Legal Proceedings." See "Management's Discussion and Analysis of Financial Condition and Results of Operations — Liquidity and Capital Resources."

### **Employees**

As of December 31, 2000, the Company had 537 full-time and 4 part-time employees, of whom 11 are senior management personnel, 245 are collections personnel, 130 are Contract origination personnel, 72 are marketing personnel (64 of whom are marketing representatives), 57 are operations and systems personnel, and 26 are administrative personnel. The Company believes that its relations with its employees are good. The Company is not a party to any collective bargaining agreement.

### **Item 2. Property**

The Company's headquarters are located in Irvine, California, where it leases approximately 115,000 square feet of general office space from an unaffiliated lessor. The annual rent is approximately \$1.9 million for the first five years of the lease term, and increases to \$2.1 million for years six through ten. The Company has the option to cancel the lease after five years without penalty. In addition to the foregoing base rent, the Company has agreed to pay the property taxes, maintenance and other expenses of the premises.

The Company in March 1997 established a branch collection facility in Chesapeake, Virginia. The Company leases approximately 28,000 square feet of general office space in Chesapeake, Virginia, at a base rent that is currently \$419,470 per year, increasing to \$504,545 over a ten-year term.

### **Item 3. *Legal Proceedings***

On October 29, 1999, three ex-employees of LINC filed an involuntary petition under Chapter 7 of the Bankruptcy Code, naming LINC as the debtor, and seeking its liquidation. The petition was filed in the U.S. Bankruptcy Court for the District of Connecticut. Among the allegations asserted against the Company is that LINC is entitled to a retained interest in the Contracts sold by LINC in securitizations, and thus to a share of the distributions from the securitized pools. The Company intends to contest vigorously this matter.

On May 12, 2000, Jon L. Kunert and Penny Kunert commenced a lawsuit against an automobile dealer, the Company and in excess of 20 other defendants in the Superior Court of California, Los Angeles County. The defendants other than the automobile dealer appear to be various entities (“finance defendants”) that may have purchased retail installment contracts from that dealer. The lawsuit alleges that the various finance defendants conspired with the automobile dealer defendant to conceal from motor vehicle purchasers the full cost of credit applicable to their purchases, and seeks a refund of the concealed excess cost. The court has ordered the plaintiffs to file separate lawsuits against each finance defendant. As of the date of this report, the Company is not aware that any such lawsuit has been filed. The Company intends to contest vigorously any such lawsuit, when and if it is filed.

On August 15, 2000, Linda McGee filed a lawsuit in the New Jersey Circuit Court of Gloucester County alleging that she, and a purported 48-state class, were defrauded by a “conspiracy” among the Company and unspecified automobile dealers. The alleged object of the conspiracy was to conceal from plaintiff the minimum interest rate at which the Company would be willing to finance a vehicle purchase, and thus to gain for the dealer the additional amount that the Company is willing to pay for higher-rate Contracts. The complaint seeks damages in an unspecified amount. The 48-state class alleged by plaintiff is defined to exclude the states of Alabama and Tennessee, where similar lawsuits against other auto finance companies have failed.

On November 15, 2000, Denice and Gary Lang filed a lawsuit in South Carolina Common Pleas Court, Beaufort County, alleging that they, and a purported nationwide class, were harmed by an alleged failure to refer, in the notice given after repossession of their vehicle, of the right to purchase the vehicle by tender of the full amount owed under the retail installment contract. They seek damages in an unspecified amount.

Approximately 12 plaintiffs have filed seven lawsuits against approximately 50 defendants, all arising out of the failure of Stanwich Financial Services Corp. (“SFSC”) to make certain payments when due in November 2000. The defendants include SFSC, numerous financial institutions, Charles Bradley, Sr., Charles Bradley, Jr. and the Company. The five lawsuits that name the Company as a defendant allege, in essence, that the Company acted as the alter-ego of Charles Bradley, Sr. in connection with the acquisition of SFSC by a corporation controlled by Mr. Bradley, and that Mr. Bradley wrongfully caused SFSC to not pay its obligations to the plaintiffs. Among the acts alleged to be wrongful are the actions of SFSC in lending the Company an aggregate of \$20.5 million. Since the filing of the first such lawsuit, the Company has prepaid to SFSC \$4 million of such indebtedness. As of the date of this report, the Company has not been required to respond to any of the seven lawsuits, and is in the process of retaining counsel to appear on its behalf. The Company intends to contest vigorously this litigation.

It is management’s opinion, based on the advice of counsel, that all litigation of which it is aware, including the matters discussed above, will not have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity, beyond reserves already taken.

### **Item 4. *Submission of Matters to a Vote of Security Holders***

Not applicable.

#### **Item 4a. Executive Officers of the Registrant**

Information regarding the Company's executive officers follows:

*Charles E. Bradley, Jr.*, 41, has been the President and a director of the Company since its formation in March 1991. In January 1992, Mr. Bradley was appointed Chief Executive Officer of the Company. From March 1991 until December 1995 he served as Vice President and a director of CPS Holdings, Inc. 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, Jr. is currently serving as a director of NAB Asset Corporation, and Reunion Industries, Inc. Charles E. Bradley, Sr., Chairman of the board of directors of the Company, is his father.

*William L. Brummund, Jr.*, 48, has been Senior Vice President - Operations since March 1991. From 1986 to March 1991, Mr. Brummund was Vice President and Systems Administrator for Far Western Bank.

*Nicholas P. Brockman*, 56, has been Senior Vice President - Asset Recovery & Liquidation since January 1996. He was Senior Vice President of Contract Originations from April 1991 to January 1996. From 1986 to March 1991, Mr. Brockman served as a Vice President and Branch Manager of Far Western Bank.

*Richard P. Trotter*, 57, has been Senior Vice President-Contract Origination since January 1996. He was Senior Vice President of Administration from April 1995 to December 1995. From January 1994 to April 1995 he was Senior Vice President-Marketing of the Company. From December 1992 to January 1994, Mr. Trotter was Executive Vice President of Lange Financial Corporation, Newport Beach, California. From May 1992 to December 1992, he was Executive Director of Fabozzi, Prenovost & Normandin, Santa Ana, California. From December 1990 to May 1992 he was Executive Vice President/Chief Operating Officer of R. Thomas Ashley, Newport Beach, California. From April 1984 to December 1990, he was President/Chief Executive Officer of Far Western Bank, Tustin, California.

*Curtis K. Powell*, 44, has been Senior Vice President - Marketing of the Company since April 1995. He joined the Company 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.

*Mark A. Creatura*, 41, 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.

*Thurman Blizzard*, 58, has been Senior Vice President - Risk Management since May 1999, and was Senior Vice President-Collections from January 1998 until May 1999. The Company had previously engaged Mr. Blizzard as a consultant from October 1997 to December 1997 to provide recommendations to the Company concerning its collections operation. Prior thereto, Mr. Blizzard served as Chief Operations Officer of Monaco Finance from May 1994 to March 1997. Mr. Blizzard was previously an Asset Liquidation Manager with the Resolution Trust Corporation, from November 1991 to May 1994.

*Kris I. Thomsen*, 43, has been Senior Vice President - Systems since June 1999. Previously, Ms. Thomsen had been Vice President-Systems since the Company's inception in March 1991.

*James L. Stock*, 35, has been Senior Vice President - Chief Financial Officer of the Company since January 2000. Prior to being named the Chief Financial Officer, Mr. Stock was the Vice President and Corporate Controller of the Company. From August 1993 to December 1994, Mr. Stock was the assistant controller of Fluid Recycling Services, an industrial fluids management company based in Santa Ana, California. From July 1990 to August 1993, Mr. Stock was a senior associate with Coopers & Lybrand.

## PART II

### Item 5. Market for Common Equity and Related Stockholder Matters

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

	<u>High</u>	<u>Low</u>
January 1-March 31, 1999.....	5.250	2.813
April 1-June 30, 1999.....	4.313	1.031
July 1-September 30, 1999.....	1.813	0.938
October 1-December 31, 1999.....	1.875	0.438
January 1-March 31, 2000.....	2.938	1.313
April 1-June 30, 2000.....	2.250	0.688
July 1-September 30, 2000.....	1.938	1.031
October 1-December 31, 2000.....	1.938	1.125

As of March 22, 2001, there were 79 holders of record of the Company's Common Stock. To date, the Company has not declared or paid any dividends on its Common Stock. The payment of future dividends, if any, on the Company's Common Stock is within the discretion of the Board of Directors and will depend upon the Company's earnings, its capital requirements and financial condition, and other relevant factors. The instruments governing the Company's outstanding debt place certain restrictions on the payment of dividends. The Company does not intend to declare any dividends on its Common Stock in the foreseeable future, but instead intends to retain any earnings for use in the Company's operations.

**Item 6. Selected Financial Data**

	Year ended December 31,				
	2000	1999	1998	1997	1996
	(in thousands, except per share data)				
<b>Statement of Operations Data:</b>					
Gain (loss) on sale of Contracts, net.....	\$ 16,234	\$ (14,844)	\$ 58,306	\$ 35,045	\$ 20,565
Interest income .....	3,480	3,032	41,841	23,526	19,980
Servicing fees .....	15,848	27,761	25,156	14,487	7,893
Total revenue.....	35,951	14,805	126,280	75,251	48,438
Operating expenses.....	68,354	86,968	81,960	43,292	24,746
Net income (loss) .....	(22,147)	(44,532)	25,703	18,532	14,097
Basic earnings (loss) per share(1).....	(1.10)	(2.38)	1.67	1.29	1.05
Diluted net earnings (loss) per share(1).....	(1.10)	(2.38)	1.50	1.17	0.93
	December 31,				
	2000	1999	1998	1997	1996
	(in thousands)				
<b>Balance Sheet Data:</b>					
Contracts held for sale.....	\$ 18,830	\$ 2,421	\$ 165,582	\$ 68,271	\$ 21,657
Residual interest in securitizations .....	99,199	172,530	217,848	124,616	43,597
Total assets .....	175,694	220,314	431,962	225,895	101,946
Term debt .....	102,614	119,173	274,546	119,719	36,265
Total liabilities .....	113,572	135,877	312,881	143,288	44,989
Total shareholders' equity .....	62,122	84,437	119,081	82,607	56,957

(1) All prior periods have been restated in accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share."

## **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following analysis of the financial condition of the Company should be read in conjunction with "Selected Financial Data" and the Company's Consolidated Financial Statements and the Notes thereto and the other financial data included elsewhere in this report.

### **Overview**

Consumer Portfolio Services, Inc. and its subsidiaries (collectively, the "Company") primarily engage in the business of purchasing, selling and servicing retail automobile installment sale contracts ("Contracts") originated by automobile dealers ("Dealers") located throughout the United States. In the past, the Company has purchased contracts in as many as 44 different states. At various times in 1999, the Company suspended its solicitation of Contract purchases in as many as 20 states, and as of the date of this report is active in 34 states. There can be no assurance as to resumption of Contract purchasing activities in other states. Through its purchase of Contracts, the Company provides indirect financing to Dealer customers with limited credit histories, low incomes or past credit problems, who generally would not be expected to qualify for financing provided by banks or by automobile manufacturers' captive finance companies.

The Company historically has generated revenue primarily from the gains recognized on the sale or securitization of its Contracts, servicing fees earned on Contracts sold, and interest earned on Residuals (as defined below) and on Contracts held for sale. Beginning with the year ended December 31, 1999, and through the date of this report, the Company did not sell any Contracts in securitization transactions, and therefore recognized no gains on sale. All sales of Contracts during 1999 were on a servicing released basis either in the form of bulk sales of Contracts being held by the Company for sale, or as part of a pass through agreement with a third party for which the Company earned fees on a per Contract basis. During the year ended December 31, 2000, the Company entered into a second third party pass through agreement and proceeded to sell nearly all of the Contracts purchased during the year to one or the other third party, for a mark-up above what the Company pays the Dealer. There were no bulk sales during 2000. As a result of the Company's pass through sales during the year ended December 31, 2000, the Company recognized a \$16.2 million gain on sale of Contracts, compared to a net loss on sale of Contracts for the year ended December 31, 1999, of \$14.8 million. During the year ended December 31, 1998, the Company recognized a net gain on sale of \$58.3 million. Revenues from interest and servicing fees for the year ended December 31, 2000, were \$3.5 million and \$15.8 million, respectively. Such revenues for the year ended December 31, 1999, were \$3.0 million and \$27.8 million, respectively, and for the year ended December 31, 1998, such revenues were \$41.8 million and \$25.2 million, respectively. The Company's income is affected by losses incurred on Contracts, whether such Contracts are held for sale or have been sold in securitizations. The Company's cash requirements have been significant in the past and will continue to be significant in the future. Net cash provided by operating activities for the year ended December 31, 2000, was approximately \$38.7 million, compared to net cash used in operating activities of approximately \$180,000 for the year ended December 31, 1999, and net cash used in operating activities of approximately \$71.1 million for the year ended December 31, 1998. See "Liquidity and Capital Resources."

The Company has purchased Contracts with the primary intention of reselling them in securitization transactions as asset-backed securities. From late May 1999 to the present, the Company has purchased Contracts on a flow basis for third parties; that is, the Company purchases a Contract from a Dealer, and sells the Contract the next day to the third party for a mark-up above what the Company pays the Dealer. The Company retains no interest in such Contracts, and neither services such Contracts nor earns a servicing fee.

Although the Company has not been able to sell Contracts in a securitization transaction since December 1998, it does plan to securitize in the future, as to which there can be no assurance. The Company's securitization structure has been as follows:

First, the Company sells a portfolio of Contracts to a wholly owned subsidiary ("SPS"), which has been established for the limited purpose of buying and reselling the Company's Contracts. The SPS then transfers the same Contracts to either a grantor trust or an owner trust (the "Trust"). The Trust in turn issues interest-bearing asset-backed securities (the "Certificates"), generally in a principal amount equal to the aggregate principal balance of the Contracts. The Company typically sells these Contracts to the Trust at face value and without recourse, except

that representations and warranties similar to those provided by the Dealer to the Company are provided by the Company to the Trust. One or more investors purchase the Certificates issued by the Trust; the proceeds from the sale of the Certificates are then used to purchase the Contracts from the Company. The Company purchases a financial guaranty insurance policy, guaranteeing timely payment of principal and interest on the senior Certificates, from an insurance company (the "Certificate Insurer"). In addition, the Company provides a credit enhancement for the benefit of the Certificate Insurer and the investors in the form of an initial cash deposit to an account ("Spread Account") held by the Trust. The agreements governing the securitization transactions (collectively referred to as the "Servicing Agreements") require that the initial deposits to the Spread Accounts be supplemented by a portion of collections from the Contracts until the Spread Accounts reach specified levels, and then maintained at those levels. The specified levels are generally computed as a percentage of the principal amount remaining unpaid under the related Certificates. The specified levels at which the Spread Accounts are to be maintained will vary depending on the performance of the portfolios of Contracts held by the Trusts and on other conditions, and may also be varied by agreement among the Company, the SPS, the Certificate Insurer and the trustee. Such levels have increased and decreased from time to time based on performance of the portfolios, and have also been varied by agreement. The specified levels applicable to the Company's sold pools increased materially in 1998. Effective November 3, 1999, as applied to monthly measurement dates from September 1999 onward, the specified levels have decreased, as is discussed under the heading "Liquidity and Capital Resources."

At the closing of each securitization, the Company removes from its consolidated balance sheet the Contracts held for sale and adds to its consolidated balance sheet (i) the cash received and (ii) the estimated fair value of the ownership interest that the Company retains in the Contracts sold in the securitization. That retained interest (the "Residual") consists of (a) the cash held in the Spread Account and (b) the net interest receivables ("NIRs"). NIRs represent the estimated discounted cash flows to be received by the Trust in the future, net of principal and interest payable with respect to the Certificates, and certain expenses. The excess of the cash received and the assets retained by the Company over the carrying value of the Contracts sold, less transaction costs, equals the net gain on sale of Contracts recorded by the Company.

The Company allocates its basis in the Contracts between the Certificates and the Residuals retained based on the relative fair values of those portions on the date of the sale. The Company recognizes gains or losses attributable to the change in the fair value of the Residuals, which are recorded at estimated fair value and accounted for as "held-for-trading" securities. The Company is not aware of an active market for the purchase or sale of interests such as the Residuals; accordingly, the Company determines the estimated fair value of the Residuals by discounting the amount and timing of anticipated cash flows released from the Spread Account (the cash out method), using a discount rate that the Company believes is appropriate for the risks involved. For that valuation, the Company has used an effective discount rate of approximately 14% per annum.

The Company receives periodic base servicing fees for the servicing and collection of the Contracts. In addition, the Company is entitled to the cash flows from the Residuals that represent collections on the Contracts in excess of the amounts required to pay principal and interest on the Certificates, the base servicing fees, and certain other fees (such as trustee and custodial fees). At the end of each collection period, the aggregate cash collections from the Contracts are allocated first to the base servicing fees and certain other fees such as trustee and custodial fees for the period, then to the Certificateholders for interest at the pass-through rate on the Certificates plus principal as defined in the Servicing Agreements. If the amount of cash required for the above allocations exceeds the amount collected during the collection period, the shortfall is drawn from the Spread Account. If the cash collected during the period exceeds the amount necessary for the above allocations, and there is no shortfall in the related Spread Account, the excess is released to the Company, or in certain cases is transferred to other Spread Accounts that may be below their specified levels. Pursuant to certain Servicing Agreements, excess cash collected during the period is used to make accelerated principal paydowns on certain Certificates to create over-collateralization, that is, to reduce the aggregate principal balance of outstanding Certificates below the aggregate principal amount of the related automotive receivables. If the Spread Account balance is not at the required credit enhancement level, then the excess cash collected is retained in the Spread Account until the specified level is achieved. The cash in the Spread Accounts is restricted from use by the Company. Cash held in the various Spread Accounts is invested in high quality, liquid investment securities, as specified in the Servicing Agreements. Spread Account balances are held by the Trusts on behalf of the Company as the owner of the Residuals.

The annual percentage rate payable on the Contracts is significantly greater than the rates payable on the Certificates. Accordingly, the Residuals described above are a significant asset of the Company. In determining the value of the Residuals described above, the Company must estimate the future rates of prepayments, delinquencies, defaults and default loss severity, as they affect the amount and timing of the estimated cash flows. The Company estimates prepayments by evaluating historical prepayment performance of comparable Contracts. The Company has used a constant prepayment estimate of approximately 4% per annum. The Company estimates defaults and default loss severity using available historical loss data for comparable Contracts and the specific characteristics of the Contracts purchased by the Company. In valuing the Residuals, the Company estimates that losses as a percentage of the original principal balance will range from 14% to 17.0% cumulatively over the lives of the related Contracts.

In future periods, the Company could recognize additional revenue from the Residuals if the actual performance of the Contracts were to be better than originally estimated, or the Company could increase the estimated fair value of the Residuals. If the actual performance of the Contracts were to be worse than the original estimate, then a downward adjustment to the carrying value of the Residuals would be required. Due to the inherent uncertainty of the future performance of the underlying Contracts, the Company has established a provision for future losses on the Residuals.

From March 1999 to the present, the Company has been unable to complete a securitization transaction, due to unavailability of sufficient capital. The above description is included because the Residuals created in past securitizations continue to represent the Company's largest asset, and because the Company plans again to sell Contracts in securitization transactions, when necessary pre-conditions (including availability of capital) are fulfilled.

During the year ended December 31, 1999, the Company has altered its basic system of doing business. Previously, the Company would acquire Contracts for its own account, borrowing from 88% to 97% of the principal balance of such Contracts under "warehouse" lines of credit. Periodically (approximately once every quarter) the Company would then sell most or all of the recently acquired Contracts in a securitization transaction as described above. In such a sale, the Company would retain (1) a residual ownership interest in the Contracts sold, (2) the obligation to service the Contracts sold, and (3) the right to receive servicing fees. At the end of March 1999, the Company learned that it would be unable to sell Contracts in securitization transactions for an indeterminate period. Accordingly, the Company commenced purchasing Contracts for immediate re-sale to a third party, which third party purchases the Contracts in turn on a daily basis for a mark-up above what the Company pays the Dealer. In this arrangement, the Company retains no residual interest in the Contracts, has no servicing obligation, and receives no servicing fee.

In November 2000, the Company entered into a one year revolving note purchase facility under which up to \$75 million of notes may be outstanding at any time subject to a collateral test and other conditions. The Company uses funds derived from this facility to purchase Contracts, which are pledged to secure the Notes. Such Contracts are held for sale in anticipated future securitization transactions, as to which there can be no assurance. The collateral test generally allows the Company to borrow up to approximately 75% of the price paid for such Contracts. Notes issued under this facility bear interest at one-month LIBOR plus 0.30% per annum.

## **Results of Operations**

### *The Year Ended December 31, 2000 Compared to the Year Ended December 31, 1999*

*Revenue.* During the year ended December 31, 2000, revenues increased \$21.1 million, or 142.8%, compared to the year ended December 31, 1999. Net gain on sale of Contracts increased by \$31.1 million, from a \$14.8 million loss on sale for the year ended December 31, 1999, to a \$16.2 million gain for the year ended December 31, 2000. The primary reason for the increase is that the prior year included sales of some \$318.0 million of Contracts for less than their acquisition costs, resulting in a loss on sale of \$15.2 million. Net gain on sale also increased due to an increase in the number of Contracts sold on a flow basis, and an increase in the average fee paid to the Company per Contract sold. During the year ended December 31, 2000, the Company sold \$600.4 million of Contracts on a flow basis compared to \$241.2 million of Contracts in the year ended December 31, 1999. For the years ended December

31, 2000 and 1999, \$1.8 million and \$5.3 million, respectively, of provision for losses on Contracts held for sale was charged against gain on sale.

Interest income increased by \$448,000, or 14.8%, representing 9.7% of total revenues for the year ended December 31, 2000. Prior to the second quarter of the year 2000, the Company recognized residual interest income as the excess cash flows generated by the Trusts over the related obligations of the Trusts. This method of residual interest income recognition approximated a level yield rate of residual interest income, net of the amortization of the NIRs, primarily due to the continued addition of new securitizations. As a result of the Company's not having securitized any Contracts since December 1998, the Company's existing method of amortizing the Residuals would not reflect the appropriate level yield. Therefore, the Company refined its methodology to accrete residual interest income on a level yield basis, using an accretion rate that approximates the discount rate used to value the residual interest in securitizations. That rate is 14% per annum.

Servicing fees decreased by \$11.9 million, or 42.9%, and represented 44.1% of total revenue. Servicing fees are composed of base fees, which are payable at the rate of 2% per annum on the principal balance of the outstanding Contracts in the related trusts, plus any other fees collected by the Company, such as late fees and returned check fees. The decrease in servicing fees is primarily due to the decrease in the Company's servicing portfolio. As of December 31, 2000, the servicing portfolio was \$411.9 million compared to \$821.0 million as of December 31, 1999.

*Expenses.* During the year ended December 31, 2000, operating expenses decreased by \$18.6 million, or 21.4%, compared to the year ended December 31, 1999. Employee costs decreased by \$5.2 million, or 17.4%, and represented 36.0% of total operating expenses. The decrease is due to the reductions of staff in accordance with the decrease in the Company's servicing portfolio. The decrease was offset by an increase in employee costs of \$778,000 related to the valuation of certain stock options in accordance with recently issued accounting principles. General and administrative expenses decreased by \$3.8 million, or 19.6% and represented 23.1% of total operating expenses. The decrease in general and administrative expenses is primarily due to the decrease in costs associated with servicing the Company's portfolio. Such costs include telephone, postage, and lockbox processing fees.

Interest expense decreased by \$10.2 million, or 37.1%, and represented 25.2% of total operating expenses. The decrease in interest expense is primarily due to the reductions in warehouse and non-warehouse indebtedness from the prior year. (See "Liquidity and Capital Resources").

Marketing expenses increased by \$703,000 or 13.0%, and represented 9.0% of total expenses. The increase is primarily due to the increase in Contracts purchased during the year ended December 31, 2000. Fees paid to marketing representatives for their role in the submission of Contracts ultimately purchased by the Company are included as a component in gain on sale of Contracts, net.

Occupancy expenses increased by \$615,000 or 22.0%, and represented 5.0% of total expenses. The increase is primarily due to additional property taxes paid during 2000. Depreciation and amortization expenses decreased by \$434,000 or 27.2%, and represented 1.7% of total expenses. In November 1998, the Company moved its headquarters to a new 115,000 square foot facility. The Company is leasing the new headquarters facility for a ten-year term, with base rent of \$1.9 million for the first five years, and \$2.1 million for years six through ten. In addition to base rent, the Company pays property taxes, maintenance, and other expenses of the property.

The results for the years ended December 31, 2000 and 1999, include net losses of \$19,816 and net earnings of \$35,131 respectively, from the Company's subsidiary CPS Leasing, Inc.

The results for the year ended December 31, 2000, include a net operating loss of \$755,000 from the Company's investment in 38% of NAB Asset Corp. The results for the year ended December 31, 1999, include \$2.5 million in net earnings from the Company's investment in NAB Asset Corp.

The Company's effective tax rate was 31.7% and 38.3%, for the years ended December 31, 2000 and 1999, respectively. The decline in the effective tax rate in 2000 reflects the full utilization of net operating loss carryback availability, and the recording of a \$3.7 million valuation allowance on a portion of the Company's net deferred tax assets.

*The Year Ended December 31, 1999 Compared to the Year Ended December 31, 1998*

*Revenue.* During the year ended December 31, 1999, revenue decreased \$111.5 million, or 88.3%, compared to the year ended December 31, 1998. Gain on sale of Contracts, net, decreased by \$73.2 million, or 125.5%, from a \$58.3 million gain on sale for the year ended December 31, 1998, to a \$14.8 million loss for the year ended December 31, 1999. The change in gain on sale from positive to negative is due to the Company selling Contracts only on a servicing released basis and thus not recording any NIR gains during the year, as well as to selling Contracts at a loss. During the year ended December 31, 1999, the Company sold \$318.0 million of Contracts on a servicing released basis, that is, with no residual interest retained, with no servicing obligation, and with no right to receive a servicing fee. Those sales resulted in a net loss of approximately \$15.2 million. Expenses of approximately \$1.1 million were incurred related to previous securitization transactions, including the amortization of a warrant issued to the Certificate Insurer in November 1998. In addition, the Company sold \$241.2 million of Contracts on a flow through basis and received \$6.2 million of fees, which have been included as a component of gain on sale of Contracts, net. For the years ended December 31, 1999 and 1998, \$5.3 million and \$3.5 million, respectively, of provision for losses on Contracts held for sale were charged against gain on sale. The increase in the provision for losses on Contracts held for sale is primarily due to the Company's inability to securitize Contracts during 1999. As a result, Contracts were held for sale for longer periods of time prior to being sold on a servicing released basis, thus requiring additional loss reserves.

Interest income decreased by \$38.8 million, or 92.8%, representing 20.5% of total revenues for the year ended December 31, 1999. The decrease is primarily due to decreases in Contracts held for sale and NIRs during 1999. Beginning in May 1999, the Company began to purchase Contracts on a flow through basis and thus did not hold any additional Contracts for sale since that time. Additionally, the Company completed the final sale of Contracts on a servicing released basis, other than those sold on a flow through basis, on September 1, 1999, leaving approximately \$4.6 million of Contracts held for sale at the end of September and decreasing to \$2.4 million by year end.

Servicing fees increased by \$2.6 million, or 10.4%, and represented 187.5% of total revenue. Servicing fees are composed of base fees, which are payable at the rate of 2% per annum on the principal balance of the outstanding Contracts in the related trusts, plus any other fees collected by the Company, such as late fees and returned check fees. The increase in servicing fees is primarily due to an increase in the fees other than base fees collected during 1999. During the year ended December 31, 1999, the Company collected \$4.9 million of other servicing fees, an increase of 39.7% over other servicing fees collected in the prior year.

*Expenses.* During the year ended December 31, 1999, operating expenses increased \$5.0 million, or 6.1%, compared to the year ended December 31, 1998. Employee costs increased by \$1.0 million, or 3.5%, and represented 34.3% of total operating expenses. The increase is due to increases in salaries and wage rates. General and administrative expenses decreased by \$1.0 million, or 4.9% and represented 22.5% of total operating expenses. The decrease in general and administrative expenses is primarily due to the decrease in costs associated with purchasing Contracts such as credit reports. During the year ended December 31, 1999, the Company purchased \$424.7 million of Contracts, compared to \$1,076.5 million of Contracts purchased in the prior year.

Interest expense increased \$5.4 million, or 24.5%, and represented 31.5% of total operating expenses. The increase is due in part to the interest paid on \$25.0 million in subordinated debt securities issued by the Company in November 1998, and \$6.5 million of additional subordinated debt securities issued during the year ended December 31, 1999. In addition, the interest rate on the \$25.0 million of subordinated debt issued in November 1998, was increased from 13.5% in 1998 to 14.5% in April of 1999. Interest expense was also affected by the volume of Contracts held for sale, as well as by the Company's cost of borrowed funds. (See "Liquidity and Capital Resources").

Marketing expenses decreased by \$1.5 million or 21.3%, and represented 6.2% of total expenses. The decrease is primarily due to the decrease in Contracts purchased during the year ended December 31, 1999. Fees paid to marketing representatives for their role in the submission of Contracts ultimately purchased by the Company are included as a component in gain on sale of Contracts, net.

Occupancy expenses increased by \$526,000 or 23.2%, and represented 3.2% of total expenses. Depreciation and amortization expenses increased by \$340,000 or 27.1%, and represented 1.8% of total expenses. In November 1998, the Company moved its headquarters to a new 115,000 square foot facility. The Company is leasing the new headquarters facility for a ten-year term, with base rent of \$1.9 million for the first five years, and \$2.1 million for years six through ten. In addition to base rent, the Company pays property taxes, maintenance, and other expenses of the property.

The results for the years ended December 31, 1999, and 1998, include a net operating loss of approximately \$150,000 and \$1.1 million, respectively, from the Company's subsidiary Samco. Samco terminated all of its operations during the first quarter of 1999.

The results for the year ended December 31, 1999, include a net operating loss of \$830,380 from the Company's subsidiary LINC. For the year ended December 31, 1998, LINC had net operating losses of \$565,333. During the second quarter of 1999, LINC ceased all operations.

The results for the years ended December 31, 1999 and 1998, include net earnings of \$35,131 and \$298,000, respectively, from the Company's subsidiary CPS Leasing, Inc.

The results for the year ended December 31, 1999, include a net operating loss of \$2.5 million from the Company's investment in 38% of NAB Asset Corp. The results for the year ended December 31, 1998, include \$52,000 in net earnings from the Company's investment in NAB Asset Corp.

The Company's effective tax rate was 38.3% and 42.0%, for the years ended December 31, 1999 and 1998, respectively.

## **Liquidity and Capital Resources**

### *Liquidity*

The Company's business requires substantial cash to support its purchases of Contracts and other operating activities. The Company's primary sources of cash from operating activities have been proceeds from sales of Contracts, amounts borrowed under lines of credit, servicing fees on portfolios of Contracts previously sold, customer payments of principal and interest on Contracts held for sale, fees received from its flow purchase programs for origination of Contracts, and releases of cash from Spread Accounts. The Company's primary uses of cash have been the purchases of Contracts, repayment of amounts borrowed under lines of credit and otherwise, operating expenses such as employee, interest, and occupancy expenses, the establishment of and further contributions to Spread Accounts, and income taxes. Internally generated cash may or may not be sufficient to meet the Company's cash demands, depending on the performance of securitized pools (which determines the level of releases from Spread Accounts), on the rate of growth or decline in the Company's servicing portfolio, and on the terms on which the Company is able to buy, borrow against and sell Contracts.

Contracts are purchased from Dealers for a cash price close to their principal amount, and return cash over a period of years. As a result, the Company has been dependent on lines of credit to purchase Contracts, and on the availability of cash from outside sources in order to finance its continued operations, and to fund the portion of Contract purchase prices not borrowed under lines of credit. For much of the three-year period ended December 31, 2000, the Company was not party to any line of credit that would facilitate purchase of Contracts. Furthermore, the Company did not receive any material releases of cash from Spread Accounts from June 1998 through October 1999. The inability to borrow and the lack of cash releases resulted in a liquidity deficiency, which has since been alleviated.

The Company's Contract purchasing program currently comprises both (i) purchases for the Company's own account, funded primarily by advances under a revolving credit facility, and (ii) flow purchases for the account of non-affiliates. Flow purchases allow the Company to purchase Contracts with minimal demands on liquidity. The Company's revenues from flow purchase of Contracts, however, are materially less than may be received by holding Contracts to maturity or by selling Contracts in securitization transactions. For the year ended December 31, 2000, the Company purchased \$600.4 million of Contracts on a flow basis, and \$31.1 million for its own account,

compared to \$424.7 million of Contracts purchased, \$241.2 million of which was purchased on a flow basis, in the prior year.

Net cash provided by operating activities was \$38.7 million for the year ended December 31, 2000, compared to net cash used in operating activities of \$180,000 for the same period in the prior year. During the years ended December 31, 2000, and 1999, the Company did not complete a securitization transaction, and therefore, did not use any cash for initial deposits to Spread Accounts. Cash used for subsequent deposits to Spread Accounts for the year ended December 31, 2000, was \$15.0 million, a decrease of \$8.1 million, or 34.9%, from cash used for subsequent deposits to Spread Accounts for the prior year. Cash released from Spread Accounts to the Company for the year ended December 31, 2000, was \$80.6 million, as compared with \$28.0 million for the prior year. Changes in deposits to and releases from Spread Accounts are affected by the relative size, seasoning and performance of the various pools of sold Contracts that make up the Company's Servicing Portfolio. In particular, in the prior year most of the cash generated by Contracts held by the Trusts was directed, pursuant to the Securitization Agreements, to building Spread Accounts to their respective specified levels. Those levels having been reached in November 1999, cash subsequently generated has been available for release to the Company.

From June 1998 to November 1999, the Company's liquidity was adversely affected by the absence of releases from Spread Accounts. Such releases did not occur because a number of the Trusts had incurred cumulative net losses as a percentage of the original Contract balance or average delinquency ratios in excess of the predetermined levels specified in the respective Securitization Agreements. Accordingly, pursuant to the Securitization Agreements, the specified levels applicable to the Company's Spread Accounts were increased, in most cases to an unlimited amount. Due to cross collateralization provisions of the Securitization Agreements, the specified levels were increased on all but the two most recent of the Company's Trusts. Increased specified levels for the Spread Accounts have been in effect from time to time in the past. As a result of the increased Spread Account specified levels and cross collateralization provisions, excess cash flows that would otherwise have been released to the Company instead were retained in the Spread Accounts to bring the balance of those Spread Accounts up to higher levels. In addition to requiring higher Spread Account levels, the Securitization Agreements provide the Certificate Insurer with certain other rights and remedies, some of which have been waived on a recurring basis by the Certificate Insurer with respect to all of the Trusts. Until the November 1999 effectiveness of an amendment (the "Amendment") to the Securitization Agreements, no material releases from any of the Spread Accounts were available to the Company. Upon effectiveness of the Amendment, the requisite Spread Account levels in general have been set at 21% of the outstanding principal balance of the Certificates issued by the related Trusts. The 21% level is subject to adjustment to reflect over collateralization. Older Trusts may require more than 21% of credit enhancement if the Certificate balance has amortized to such a level that "floor" or minimum levels of credit enhancement are applicable.

In the event of certain defaults by the Company, the specified level applicable to such credit enhancement could increase to an unlimited amount, but such defaults are narrowly defined, and the Company does not anticipate suffering such defaults. The Amendment has been effective since November 1999, and the Company has received releases of cash from the securitized portfolio on a monthly basis thereafter. The releases of cash are expected to continue and to vary in amount from month to month. There can be no assurance that such releases of cash will continue in the future.

Since November 2000, the Company has been able to purchase Contracts for its own account using proceeds from a \$75 million revolving note purchase facility. Approximately 75% of the acquisition cost of Contracts may be advanced to the Company under that facility (see "Credit Facilities"). The Company also purchases Contracts on a flow basis, which, as compared with purchase of Contracts for the Company's own account, involves a materially reduced demand on the Company's cash. Cash requirements are reduced because the Company need only fund such purchases for the period of several days that elapse between payment to the Dealer and receipt of funds from the flow purchasers. The Company's plan for meeting its liquidity needs is to adjust its levels of Contract purchases to match its availability of cash.

The Company's ability to adjust the quantity of Contracts that it purchases and sells will be subject to general competitive conditions and other factors. There can be no assurance that the current level of Contract acquisition can be maintained or increased. Obtaining releases of cash from the Spread Accounts is dependent on collections from

the related Trusts generating sufficient cash in excess of the amended specified levels. There can be no assurance that collections from the related Trusts will generate cash in excess of the amended specified levels.

#### *Credit Facilities*

The terms on which credit has been available to the Company for purchase of Contracts have varied over the three-year period ended December 31, 2000, as shown in the following recapitulation:

In November 1998, the Company entered into a warehouse line of credit agreement with General Electric Capital Corporation (the "GECC Line"). The GECC Line provided for warehouse facility advances up to a maximum of \$100 million at a variable interest rate of LIBOR + 3.75%. The GECC Line by its terms was to expire November 30, 1999. During 1999, the Company defaulted on the GECC Line agreements and was required to repay all balances owed. During August 1999, all amounts owed under the GECC Line were repaid and the agreement was terminated.

In November 1997, the Company entered into a warehouse line of credit agreement with First Union Capital Markets ("First Union Line"). The First Union Line provided for a maximum of \$150.0 million of advances to the Company, with interest at a variable rate indexed to prevailing commercial paper rates. In July 1998, the advance amount was increased to \$200.0 million. In conjunction with the increase in maximum advance amount under the agreement, the expiration date was changed to July 31, 1999, renewable for one year with the mutual consent of the Company and First Union Capital Markets. During 1999, the Company defaulted on the First Union Line agreement and was required to repay the balance outstanding in its entirety. In June 1999, the balance of the First Union Line was repaid in its entirety and the related agreement was terminated.

In December 1996, the Company entered into an overdraft financing facility, with a bank, that provided for maximum borrowings of \$2.0 million. Interest was charged on the outstanding balance at the bank's reference rate plus 1.75%. During 1997, the overdraft facility was increased to \$4.0 million. There were no borrowings outstanding under this facility at December 31, 1998. During 1999, the Company defaulted under the overdraft facility and was required to repay the outstanding balance in its entirety. In November 1999, the remaining balance outstanding under the overdraft facility was repaid in its entirety and the related agreement was terminated.

In November 2000, the Company entered into a revolving note purchase facility under which up to \$75 million of notes may be outstanding at any time subject to a collateral test and other conditions. The Company uses funds derived from this facility to purchase Contracts, which are pledged to secure the Notes. The collateral test generally allows the Company to borrow up to approximately 75% of the price paid for such Contracts. Notes issued under this facility bear interest at one-month LIBOR plus 0.30% per annum. The balance of notes outstanding at December 31, 2000, was \$2.0 million.

#### *Capital Resources*

In the past, the Company funded the increase in its servicing portfolio through off balance sheet securitization transactions, as discussed above, and funded its other capital needs with cash from operations and with the proceeds from the issuance of long-term debt and/or equity.

The acquisition of Contracts for subsequent sale in securitization transactions, and the need to fund Spread Accounts 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 the Company's Contract purchases (other than flow purchases), the required level of initial credit enhancement in securitizations, and the extent to which the Spread Accounts either release cash to the Company or capture cash from collections on sold Contracts. The Company plans to adjust its levels of Contract purchases so as to match anticipated releases of cash from Spread Accounts with capital requirements for securitization of Contracts that are purchased for the Company's own account.

## Capitalization

Over the three-year period ended December 31, 2000, the Company has increased its capitalization by issuing and restructuring debt and issuing/repurchasing common stock and equivalents which is summarized in the following table:

	<b>For the Years Ended December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
	(in thousands)		
<b>Senior secured debt:</b>			
Beginning balance .....	\$ 23,161	\$ 33,000	\$ —
Issuances.....	16,000	—	33,000
Payments .....	(31,161)	(9,839)	—
Restructuring .....	30,000	—	—
Ending balance .....	<u>\$ 38,000</u>	<u>\$ 23,161</u>	<u>\$ 33,000</u>
<b>Subordinated debt:</b>			
Beginning balance .....	\$ 69,000	\$ 65,000	\$ 40,000
Issuances.....	—	5,000	25,000
Payments .....	(1,301)	(1,000)	—
Restructuring .....	(30,000)	—	—
Ending balance .....	<u>\$ 37,699</u>	<u>\$ 69,000</u>	<u>\$ 65,000</u>
<b>Related party debt:</b>			
Beginning balance .....	\$ 21,500	\$ 20,000	\$ 15,000
Issuances.....	—	1,500	5,000
Ending balance .....	<u>\$ 21,500</u>	<u>\$ 21,500</u>	<u>\$ 20,000</u>
Increase (decrease) of Common Stock and equivalents.....	\$ (168)	\$ 9,888	\$ 10,771

The following review of the terms of such issuances shows that the cost of such capital increased materially in 1999, and then decreased somewhat in 2000.

In April 1998, the Company borrowed \$33.0 million as a senior secured loan, which commenced amortization in May 1999. This loan bore interest at a rate equal to 4% of per annum over LIBOR. CPS borrowed \$5.0 million from related parties in August and September 1998, the terms of which were renegotiated in November 1998, in connection with the issuance of \$25.0 million of subordinated notes to Levine Leichtman Capital Partners II, L.P. (“LLCP”). The \$25.0 million of subordinated notes issued in November 1998 accrued interest at 13.50% per annum, are due November 2003, and were issued together with warrants that allowed the investor to purchase up to an aggregate of 3,450,000 shares of the Company’s common stock at \$3.00 per share. As renegotiated, the \$5.0 million of related party loans are subordinated both to the Company’s general and secured creditors and also to the LLCP subordinated notes, accrue interest at 12.50% per annum, are due June 2004, and are convertible into an aggregate of 1,666,667 shares of the Company’s common stock at \$3.00 per share. A related party also purchased \$5.0 million of Company’s common stock in July 1998, at \$11.275 per share.

The cost of capital increased further in 1999. To meet a portion of its capital requirements, the Company on April 15, 1999, issued \$5.0 million in subordinated notes to LLCP (the “New LLCP Notes”). The notes bear interest at 14.5% per annum and include warrants to purchase 1,335,000 shares of the Company’s common stock at \$0.01 per share. As part of the agreement to issue the New LLCP Notes, the Company was required to restructure the terms of the \$25.0 million subordinated promissory notes discussed above. Such restructuring included an increase in the interest rate from 13.5% to 14.5%, a reduction in the number of warrants issued to purchase the Company’s common stock from 3,450,000 to 3,115,000, a waiver by LLCP of certain defaults under the notes sold to LLCP in November 1998, and a reduction in the exercise price of the warrants from \$3.00 per share to \$0.01 per share. Among the agreements entered into in connection with the issuance of the New LLCP Notes were agreements by Stanwich Financial Services Corp. (“SFSC”), an affiliate of the chairman of the Company’s board of directors, to purchase an additional \$15.0 million of notes and of the Company to sell such notes. The terms of such notes were to be not less favorable to the Company than (i) those that would be available in a transaction with a non-affiliate, and (ii) those applicable to the New LLCP Notes.

In August and September 1999, the Company issued \$1.5 million of such notes, bearing interest at 14.5% per annum, to SFSC. As part of that transaction, the Company also agreed to issue to SFSC warrants to purchase up to 207,000 shares of the Company's common stock at a price of \$0.01 per share.

In March 2000, the Company and LLCP restructured the outstanding indebtedness of the Company in favor of LLCP, which had been in default. In the restructuring (i) all existing defaults were waived or cured, (ii) LLCP lent an additional \$16 million ("Tranche A") to the Company, (iii) the proceeds of that loan (net of fees and expenses) were used to repay all of the Company's outstanding senior secured indebtedness, (iv) the outstanding \$30 million of subordinated indebtedness in favor of LLCP was exchanged for senior indebtedness ("Tranche B"), (v) the Company granted a blanket security interest in favor of LLCP, to secure both Tranche A and Tranche B, and (vi) LLCP released SFSC and its affiliates (including Mr. Bradley, Sr., Mr. Bradley, Jr., and Mr. Poole, directors of the Company) of any liability for failure to invest \$15 million in the Company. Tranche A is due June 2001, and bears interest at 12.50% per annum; Tranche B is due November 2003, and bears interest at 14.50% per annum. In each case the interest rate is subject to increase by 2.0% in the event of a default by the Company. In the restructuring, the Company paid a fee of \$325,000, paid accrued default interest of \$300,000, issued 103,500 shares of common stock to LLCP, and paid out-of-pocket expenses of approximately \$214,000. The shares of common stock issued were valued at approximately \$155,000, which is included in deferred interest expense to be amortized over the remaining life of the related debt. The terms of the transaction were determined by negotiation between the Company and LLCP. Also in March 2000, the Company's board of directors authorized the issuance of 103,500 shares of the Company's common stock to SFSC in conjunction with a \$1.5 million promissory note issued by the Company to SFSC in August 1999. The shares of common stock issued were valued at approximately \$155,000, which is included in deferred interest expense to be amortized over the remaining life of the related debt.

In July 2000, the Board of Directors authorized the repurchase of up to \$5,000,000 of outstanding debt and equity securities of the Company, inclusive of the mandatory annual repurchase or redemption of \$1,000,000 of the Company's outstanding "RISRS" subordinated debt securities, due 2006. As of December 31, 2000, the Company had repurchased \$1.3 million in principal amount of the RISRS, and \$1.3 million of its common stock (representing 720,752 shares). During the first quarter of 2001, the Company repurchased a total of \$8,000,000 of outstanding indebtedness held by LLCP and SFSC. The Company purchased and retired \$4,000,000 of subordinated debt held by SFSC in exchange for payment of \$3,920,000, and purchased and retired \$4,000,000 of senior secured debt held by LLCP in exchange for payment of \$4,200,000. The LLCP debt by its terms called for a prepayment penalty of 3% (or \$120,000); the additional 2% (or \$80,000) paid in connection with its February 2001 prepayment was absorbed by SFSC. LLCP holds approximately 22.6% of the Company's outstanding common shares. SFSC is an affiliate of the Company's chairman, Charles E. Bradley, Sr., and SFSC and Mr. Bradley together hold approximately 30.6% of the Company's outstanding common shares.

#### *Forward-looking Statements*

The descriptions of the Company's business and activities set forth in this report and in other past and future reports and announcements by the Company may contain forward-looking statements and assumptions regarding the future activities and results of operations of the Company. Actual results may be adversely affected by various factors including the following: increases in unemployment or other changes in domestic economic conditions which adversely affect the sales of new and used automobiles and may result in increased delinquencies, foreclosures and losses on Contracts; adverse economic conditions in geographic areas in which the Company's business is concentrated; changes in interest rates, adverse changes in the market for securitized receivables pools, or a substantial lengthening of the Company's warehousing period, each of which could restrict the Company's ability to obtain cash for new Contract originations and purchases; increases in the amounts required to be set aside in Spread Accounts or to be expended for other forms of credit enhancement to support future securitizations; the reduction or unavailability of warehouse lines of credit which the Company uses to accumulate Contracts for securitization transactions; increased competition from other automobile finance sources; reduction in the number and amount of acceptable Contracts submitted to the Company by its automobile Dealer network; changes in government regulations affecting consumer credit; and other economic, financial and regulatory factors beyond the Company's control.

*New Accounting Pronouncements*

The Company will adopt in future periods new accounting pronouncements. For information on how adoption has affected and will affect the Financial Statements, see Note 1 of Notes to Consolidated Financial Statements.

**Item 7a. Quantitative and Qualitative Disclosures About Market Risk**

**Interest Rate Risk**

There have been no significant changes in interest rate risk since December 31, 1999. The Company is not currently issuing interest bearing asset-backed securities nor is it holding any material amount of Contracts for sale. All Contracts purchased are primarily sold on a flow basis, for a mark-up above what the Company pays the Dealer. Therefore, any strategies the Company has used in the past to minimize interest rate risk do not apply currently. Described below are strategies the Company has used in the past to minimize interest rate risk.

The strategies the Company has used in the past to minimize interest rate risk include offering only fixed rate contracts to obligors, regular sales of Contracts to the Trusts, and pre-funding securitizations, whereby the amount of asset-backed securities issued exceeds the amount of Contracts initially sold to the Trusts. In pre-funding, the proceeds from the pre-funded portion are held in an escrow account until the Company sells the additional Contracts to the Trust in amounts up to the balance of the pre-funded escrow account. In pre-funded securitizations, the Company locks in the borrowing costs with respect to the Contracts it subsequently delivers to the Trust. However, the Company incurs 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 asset-backed securities outstanding.

The Company is subject to market risks due to fluctuations in interest rates primarily through its outstanding indebtedness and to a lesser extent its outstanding interest earning assets, and commitments to enter into new Contracts. The interest rate and maturity profile of the Company's indebtedness is outlined above (see "Capitalization") and included in note 12 to the consolidated financial statements. The table below outlines the carrying values and estimated fair values of such indebtedness as of December 31, 2000 and 1999.

<u>Financial Instrument</u>	<u>December 31,</u>			
	<u>2000</u>		<u>1999</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
	(in thousands)			
Warehouse lines of credit .....	\$ 2,003	\$ 2,003	\$ —	\$ —
Notes payable .....	2,414	2,414	4,006	4,006
Senior secured debt .....	38,000	38,000	23,161	23,161
Subordinated debt .....	37,699	27,709	69,000	45,678
Related party debt .....	21,500	15,803	21,500	14,233

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 the Company's financial instruments, active markets do not exist. Therefore, considerable judgments 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, 2000 and 1999, the amounts that will actually be realized or paid at settlement or maturity of the instruments could be significantly different.

**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. Certain unaudited quarterly financial information is included in the Notes to Consolidated Financial Statements, as Note 17.

**Item 9. *Changes in and Disagreements With Accountants On Accounting and Financial Disclosure***

None

**PART III**

**Item 10. *Directors and Executive Officers***

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 2001 (the "2001 Proxy Statement"). The 2001 Proxy Statement will be filed not later than April 30, 2001. 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 2001 Proxy Statement.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management***

Incorporated by reference to the 2001 Proxy Statement.

**Item 13. *Certain Relationships and Related Transactions***

Incorporated by reference to the 2001 Proxy Statement.

## PART IV

### Item 14. Exhibits, Financial Statement Schedules, and Reports On Form 8-K

(a) The financial statements listed above 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 and/or indebtedness to any person other than the Company in amounts which together exceed 5% of the total consolidated assets as shown by the most recent year-end consolidated balance sheet.

The following exhibits are filed as part of this report:

<u>Exhibit Number</u>	<u>Description</u>
3.1	Restated Articles of Incorporation(1)
3.2	Amended and Restated Bylaws(2)
4.1	Indenture re Rising Interest Subordinated Redeemable Securities (“RISRS”)(3)
4.2	First Supplemental Indenture re RISRS(3)
4.3	Form of Indenture re 10.50% Participating Equity Notes (“PENs”)(4)
4.4	Form of First Supplemental Indenture re PENs(4)
10.1	1991 Stock Option Plan & forms of Option Agreements thereunder(5)
10.2	1997 Long-Term Incentive Stock Plan(5)
10.3	Lease Agreement re Chesapeake Collection Facility(6)
10.4	Lease of Headquarters Building(7)
10.5	Partially Convertible Subordinated Note(7)
10.6	Registration Rights Agreement(7)
10.7	Residual Interest in Securitizations Revolving Credit and Term Loan Agreement dated as of April 30, 1998, between registrant and State Street Bank and Trust Company(8)
10.7a	Second Amendment Agreement dated November 17, 1998 re: State Street residual interest in Securitizations Revolving Credit and Term Loan Agreement(9)
10.7b	Amendment and Forbearance Agreement(10)
10.8	Pledge and Security Agreement dated as of April 30, 1998, between the Company and State Street Bank and Trust Company(8)
10.9	Revolving Credit and Term Note dated April 30, 1998(8)
10.10	Subscription Agreement regarding shares issued in July 1998(11)
10.11	Registration Rights Agreement regarding shares issued in July 1998(11)
10.12	Amended and Restated Motor Vehicle Installment Contract Loan and Security Agreement(9)
10.13	FSA Warrant Agreement dated November 30, 1998(9)
10.14	Securities Purchase Agreement dated November 17, 1998(12)
10.14a	First Amendment dated as of April 15, 1999, to Securities Purchase Agreement dated as of November 17, 1998, between the Company and Levine Leichtman Capital Partners II, L.P. (“LLCP”). (said Securities Purchase Agreement, as amended, is referred to below as the “Amended SPA”)(13)
10.14b	Amended and Restated Securities Purchase Agreement dated as of March 15, 2000, between the LLC and the Company(14)
10.15	Senior Subordinated Primary Note dated November 17, 1998(12)
10.15a	Senior Subordinated Primary Note in the principal amount of \$25,000,000, as amended and restated pursuant to the Amended SPA(13)

<u>Exhibit Number</u>	<u>Description</u>
10.16	Primary Warrant to purchase 3,450,000 shares of common stock dated November 17, 1998(12)
10.16a	Primary Warrant to Purchase 3,115,000 Shares of Common Stock, as amended and restated pursuant to the Amended SPA(13)
10.17	Investor Rights Agreement dated November 17, 1998(12)
10.17a	First Amendment to Investors Rights Agreement, dated as of April 15, 1999(13)
10.18	Waiver Agreement dated as of March 15, 2000, between LLCPC and the Company(14)
10.19	Amended and Restated Investor Rights Agreement dated as of March 15, 2000(14)
10.20	Registration Rights Agreement dated as of November 17, 1998(12)
10.20a	First Amendment to Registration Rights Agreement, dated as of April 15, 1999(13)
10.20b	Amended and Restated Registration Rights Agreement dated as of March 15, 2000, between LLCPC and the Company(14)
10.21	Subordination Agreement dated as of November 17, 1998 re: Stanwich Note and Poole Note(9)
10.22	Investment Agreement and Continuing Guaranty, dated as of April 15, 1999(13)
10.23	Termination and Settlement Agreement with Respect to Investment Agreement and Continuing Guaranty dated as of March 15, 2000(14)
10.24	Consolidated Registration Rights Agreement dated November 17, 1998 re: 1997 Stanwich Notes(9)
10.25	Securities Purchase Agreement dated as of April 15, 1999, between the Company and LLCPC(13)
10.26	Senior Subordinated Note in the principal amount of \$5,000,000(13)
10.27	Amended and Restated Secured Senior Note Due 2003 in the principal amount of \$30,000,000(14)
10.28	Secured Senior Note Due 2001 in the principal amount of \$16,000,000(14)
10.29	Warrant to Purchase 1,335,000 Shares of Common Stock(13)
10.30	FSA Letter Agreement dated November 17, 1998(9)
10.31	Agreement dated May 29, 1999 for Sale of Contracts on a Flow Basis(15)
10.32	Amendment to Master Spread Account Agreement(16)
10.33	Sale and Servicing Agreement dated November 17, 2000 (to be filed by amendment)
10.34	Indenture dated as of November 17, 2000 (to be filed by amendment)
21.1	Subsidiaries of the Company(9)
23.1	Consent of independent auditors (filed herewith)

Each exhibit marked above with a number enclosed in parentheses is incorporated in this report by reference. The reference is to the report filed by or with respect to Consumer Portfolio Services, Inc. as specified below:

- 
- (1) Form 10-KSB dated December 31, 1995
  - (2) Form 10-K dated December 31, 1997
  - (3) Form 8-K filed December 26, 1995
  - (4) Form S-3, no. 333-21289
  - (5) Form 10-KSB dated March 31, 1994
  - (6) Form 10-K dated December 31, 1996
  - (7) Form 10-Q dated September 30, 1997
  - (8) Form 10-Q dated March 31, 1998
  - (9) Form 10-K dated December 31, 1998
  - (10) Form 10-Q dated September 30, 1999

- (11) Form 10-Q dated June 30, 1998
- (12) Schedule 13D filed November 25, 1988
- (13) Schedule 13D filed on April 21, 1999
- (14) Schedule 13D filed on March 24, 2000
- (15) Form 10-Q dated June 30, 1999
- (16) Form 10-K dated December 31, 1999

(b) Reports on Form 8-K

During the last quarter of the fiscal year ended December 31, 2000, the Company filed no reports on Form 8-K.



## INDEX TO FINANCIAL STATEMENTS

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors  
Consumer Portfolio Services, Inc.:

We have audited the accompanying consolidated balance sheets of Consumer Portfolio Services, Inc. and subsidiaries (the "Company") as of December 31, 2000 and 1999, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the years in the three-year period ended December 31, 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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, 2000 and 1999, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America.

KPMG LLP

Orange County, California  
March 29, 2001

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**  
(in thousands, except share and per share data)

	<u>December 31,</u> <u>2000</u>	<u>December 31,</u> <u>1999</u>
<b>ASSETS</b>		
Cash.....	\$ 19,051	\$ 1,290
Restricted cash (note 2).....	5,264	2,034
Contracts held for sale (note 3).....	18,830	2,421
Servicing fees receivable.....	3,204	9,919
Residual interest in securitizations (note 4).....	99,199	172,530
Furniture and equipment, net (notes 7 and 10).....	2,559	3,040
Taxes receivable (note 11).....	—	1,663
Deferred financing costs (notes 8 and 12).....	1,898	2,488
Investment in unconsolidated affiliates (note 8).....	—	755
Related party receivables (note 8).....	899	901
Deferred interest expense (notes 9 and 12).....	8,102	10,720
Deferred tax asset (note 11).....	7,189	—
Other assets (notes 8 and 9).....	9,499	12,553
	<u>\$ 175,694</u>	<u>\$ 220,314</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Accounts payable & accrued expenses.....	\$ 10,958	\$ 13,637
Warehouse line of credit (note 12).....	2,003	—
Deferred tax liability (note 11).....	—	3,067
Capital lease obligation (note 10).....	998	1,506
Notes payable (note 12).....	2,414	4,006
Senior secured debt (note 12).....	38,000	23,161
Subordinated debt (note 12).....	37,699	69,000
Related party debt (note 8).....	21,500	21,500
	<u>113,572</u>	<u>135,877</u>
<b>Shareholders' Equity (notes 9 and 12)</b>		
Preferred stock, \$1 par value; authorized 5,000,000 shares; none issued.....	—	—
Series A preferred stock, \$1 par value; authorized 5,000,000 shares; 3,415,000 shares issued; none outstanding.....	—	—
Common stock, no par value; authorized 30,000,000 shares; 20,367,901 and 20,107,501 shares issued and outstanding at December 31, 2000 and December 31, 1999, respectively.....	64,277	62,421
Retained earnings (deficit).....	(131)	22,016
Deferred compensation.....	(734)	—
Treasury stock, 720,752 shares and none at December 31, 2000 and December 31, 1999, respectively, at cost.....	(1,290)	—
	<u>62,122</u>	<u>84,437</u>
Commitments and contingencies (notes 3, 4, 8, 9, 10, 11, 12, and 13).....	<u>\$ 175,694</u>	<u>\$ 220,314</u>

See accompanying notes to consolidated financial statements

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(in thousands, except per share data)

	<b>Year Ended December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Revenues:</b>			
Gain (loss) on sale of contracts, net (notes 3, 4 and 5).....	\$ 16,234	\$ (14,844)	\$ 58,306
Interest income (note 6).....	3,480	3,032	41,841
Servicing fees .....	15,848	27,761	25,156
Other income (loss) (note 8).....	389	(1,144)	977
	<u>35,951</u>	<u>14,805</u>	<u>126,280</u>
<b>Expenses:</b>			
Employee costs.....	24,634	29,820	28,812
General and administrative (note 8) .....	15,772	19,605	20,618
Interest.....	17,240	27,405	22,019
Marketing .....	6,126	5,423	6,891
Occupancy (note 10) .....	3,408	2,793	2,267
Depreciation and amortization .....	1,161	1,595	1,255
Related party consulting fees (note 8) .....	13	327	98
	<u>68,354</u>	<u>86,968</u>	<u>81,960</u>
Income (loss) before income taxes .....	(32,403)	(72,163)	44,320
Income taxes (benefit) (note 11).....	(10,256)	(27,631)	18,617
Net income (loss) .....	<u>\$ (22,147)</u>	<u>\$ (44,532)</u>	<u>\$ 25,703</u>
<b>Earnings (loss) per share (note 1):</b>			
Basic.....	\$ (1.10)	\$ (2.38)	\$ 1.67
Diluted.....	\$ (1.10)	\$ (2.38)	\$ 1.50
<b>Number of shares used in computing earnings (loss) per share (note 1):</b>			
Basic.....	20,195	18,678	15,412
Diluted.....	20,195	18,678	17,500

See accompanying notes to consolidated financial statements

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(in thousands)

	Preferred Stock		Series A Preferred Stock		Common Stock		Treasury Stock		Deferred Compensation	Notes Receivable From Exercise of Options	Retained Earnings (Deficit)	Total
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance at December 31, 1997.....	—	\$ —	—	\$ —	15,211	\$ 42,262	—	\$ —	\$ —	\$ (500)	\$ 40,845	\$ 82,607
Common stock issued upon exercise of options (notes 9 and 12).....	—	—	—	—	5	43	—	—	—	500	—	543
Common stock issued (note 8).....	—	—	—	—	443	5,000	—	—	—	—	—	5,000
Valuation of warrants issued (notes 9 and 12).....	—	—	—	—	—	5,228	—	—	—	—	—	5,228
Net income.....	—	—	—	—	—	—	—	—	—	—	25,703	25,703
Balance at December 31, 1998.....	—	\$ —	—	\$ —	15,659	\$ 52,533	—	\$ —	\$ —	\$ —	\$ 66,548	\$ 119,081
Common stock issued upon exercise of warrants (notes 9 and 12).....	—	—	—	—	4,449	44	—	—	—	—	—	44
Valuation of warrants issued and repriced (notes 9 and 12).....	—	—	—	—	—	9,844	—	—	—	—	—	9,844
Net loss.....	—	—	—	—	—	—	—	—	—	—	(44,532)	(44,532)
Balance at December 31, 1999.....	—	\$ —	—	\$ —	20,108	\$ 62,421	—	\$ —	\$ —	\$ —	\$ 22,016	\$ 84,437
Common stock issued upon exercise of options (notes 9 and 12).....	—	—	—	—	53	33	—	—	—	—	—	33
Common stock issued (note 8).....	—	—	—	—	207	311	—	—	—	—	—	311
Treasury stock.....	—	—	—	—	—	—	(721)	(1,290)	—	—	—	(1,290)
Increase in deferred compensation on stock options (note 9).....	—	—	—	—	—	1,512	—	—	(1,512)	—	—	—
Amortization of stock compensation.....	—	—	—	—	—	—	—	—	778	—	—	778
Net loss.....	—	—	—	—	—	—	—	—	—	—	(22,147)	(22,147)
Balance at December 31, 2000.....	—	\$ —	—	\$ —	20,368	64,277	(721)	\$ (1,290)	\$ (734)	\$ —	\$ (131)	\$ 62,122

See accompanying notes to consolidated financial statements

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**

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

	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
Cash flows from operating activities:			
Net income (loss) .....	\$ (22,147)	\$ (44,532)	\$ 25,703
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization .....	1,161	1,595	1,255
Amortization of deferred financing costs .....	1,129	641	356
Provision for credit losses .....	1,838	5,323	3,544
Provision for loss on NIRs .....	—	—	7,762
NIR gains recognized .....	—	—	(52,990)
Loss on sale of furniture and equipment .....	14	—	—
Gain on sale of subsidiary .....	—	—	(56)
Deferred compensation .....	778	—	—
Equity in net (income) loss of investment in unconsolidated affiliates .....	755	2,411	(187)
Releases of cash from Trusts to Company .....	80,614	27,974	16,075
Net deposits to spread accounts .....	(15,042)	(23,093)	(77,595)
Decrease in receivables from Trusts and investment in subordinated certificates .....	7,758	40,437	13,516
Changes in assets and liabilities:			
Restricted cash .....	(3,230)	(415)	(1,619)
Purchases of contracts held for sale .....	(631,530)	(424,746)	(1,076,457)
Liquidation of contracts held for sale .....	613,283	582,584	975,602
Other assets .....	12,630	6,792	(12,886)
Accounts payable and accrued expenses .....	(2,679)	4,370	(962)
Warehouse lines of credit .....	2,003	(151,857)	90,191
Deferred tax asset/liability .....	(10,256)	(20,929)	14,104
Taxes payable/receivable .....	1,663	(6,735)	3,509
Net cash provided by (used in) operating activities .....	<u>38,742</u>	<u>(180)</u>	<u>(71,135)</u>
Cash flows from investing activities:			
Proceeds from sale of investment in unconsolidated affiliate .....	—	979	—
Net related party receivables .....	2	2,367	4,027
Purchases of furniture and equipment .....	(625)	(33)	(1,308)
Net cash from sale of subsidiary .....	—	—	382
Investment in unconsolidated affiliate .....	—	—	(165)
Net cash (used in) provided by investing activities .....	<u>(623)</u>	<u>3,313</u>	<u>3,036</u>
Cash flows from financing activities:			
Increase in senior secured debt .....	16,000	—	33,000
Issuance of related party debt .....	—	1,500	5,000
Issuance of subordinated debt .....	—	5,000	25,000
Issuance of notes payable .....	—	2,147	2,461
Repayment of senior secured debt .....	(31,161)	(9,839)	—
Repayment of subordinated debt .....	(1,301)	(1,000)	—
Repayment of capital lease obligations .....	(508)	(626)	(553)
Repayment of notes payable .....	(1,592)	(697)	(824)
Payment of financing costs .....	(539)	(312)	(1,333)
Repurchase of common stock .....	(1,290)	—	—
Issuance of common stock .....	—	—	5,000
Exercise of options and warrants .....	33	44	543
Net cash (used in) provided by financing activities .....	<u>(20,358)</u>	<u>(3,783)</u>	<u>68,294</u>
Increase (decrease) in cash .....	17,761	(650)	195
Cash at beginning of period .....	1,290	1,940	1,745
Cash at end of period .....	<u>\$ 19,051</u>	<u>\$ 1,290</u>	<u>\$ 1,940</u>

See accompanying notes to consolidated financial statements

**CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES**

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

	<u>Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
Supplemental disclosure of cash flow information:			
Cash paid (received) during the period for:			
Interest.....	\$ 13,362	\$ 23,872	\$ 21,542
Income taxes, net.....	\$ (1,663)	\$ 62	\$ 1,013
Supplemental disclosure of non-cash investing and financing activities:			
Issuance of common stock upon restructuring of debt .....	\$ 311	\$ —	\$ —
Revaluation of common stock warrants.....	\$ —	\$ 9,844	\$ 5,228
Furniture and equipment acquired through capital leases.....	\$ 75	\$ —	\$ 1,193
Reclassification of subordinated debt.....	\$ 30,000	\$ —	\$ —
Stock compensation.....	\$ 778	\$ —	\$ —
Sale of PIC Leasing, Inc.			
Net assets sold .....	\$ —	\$ —	\$ 706
Net assets retained .....	—	—	(155)
Gain on sale of subsidiary .....	—	—	56
Cash received from sale of subsidiary .....	—	—	607
Less: cash relinquished upon disposition .....	—	—	(225)
Net cash received from sale of subsidiary .....	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 382</u>

See accompanying notes to consolidated financial statements

**CONSUMER PORTFOLIO SERVICES, INC.**  
**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”) engage primarily in the business of purchasing, selling and servicing retail automobile installment sale contracts (“Contracts”) originated by licensed motor vehicle dealers (“Dealers”) located throughout the United States. The Company specializes in Contracts with obligors who generally would not be expected to qualify for traditional financing, such as that provided by commercial banks or automobile manufacturers’ captive finance companies. The Company’s headquarters and principal collection facilities are located in Irvine, California and satellite collection facilities are located in Chesapeake, Virginia and Dallas, Texas.

*Principles of Consolidation*

The consolidated financial statements include the accounts of Consumer Portfolio Services, Inc. and its wholly-owned subsidiaries, CPS Marketing, Inc., Alton Receivables Corp. (“Alton”), CPS Receivables Corp. (“CPSRC”), CPS Funding Corp. (“CPSFC”), CPS Funding LLC (“CPSF2”) and CPS Warehouse Corp. (“CPSWC”). Alton, CPSRC, CPSFC and CPSWC are limited purpose corporations, and CPSF2 a limited liability company, formed to accommodate the structures under which the Company purchases and sells its Contracts. CPS Marketing, Inc. employs marketing representatives who solicit business from Dealers. The consolidated financial statements also include the accounts of SAMCO Acceptance Corp., LINC Acceptance Company, LLC, and CPS Leasing, Inc., which are 80% owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation. Investments in unconsolidated affiliates that are not majority owned are reported using the equity method. The excess of the purchase price of such subsidiaries over the Company’s share of the net assets at the acquisition date (“goodwill”) is being amortized over a period of up to fifteen years. Goodwill is reviewed for possible impairment when events or changed circumstances may affect the underlying basis of the asset. Impairment is measured by discounting operating income at an appropriate discount rate.

*Contracts Held for Sale*

Contracts held for sale include automobile installment sales contracts on which interest is precomputed and added to the amount financed. The interest on such Contracts is included in unearned financed charges. Unearned financed charges are amortized using the interest method over the remaining period to contractual maturity. Contracts held for sale are stated at the lower of cost or market value. Market value is determined by purchase commitments from investors and prevailing market prices where available. Gains and losses are recorded as appropriate when Contracts are sold. The Company considers a transfer of Contracts where the Company surrenders control over the Contracts to be a sale to the extent that consideration other than beneficial interests in the transferred Contracts is received in exchange for the Contracts.

*Contracts Held to Maturity*

Contracts held to maturity are presented at cost and are included in other assets. Payments received on Contracts held to maturity are restricted to certain securitized pools, and the related Contracts cannot be resold.

*Allowance for Credit Losses*

The Company estimates an allowance for credit losses, which management believes provides adequately for known and inherent losses that may develop in the Contracts held for sale. Provision for loss is charged to gain on sale of Contracts. Charge offs, net of recoveries, are charged to the allowance. Management evaluates the adequacy of the allowance by examining current delinquencies, the characteristics of the portfolio and the value of the underlying collateral.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Contract Acquisition Fees*

Upon purchase of a Contract from a Dealer, the Company generally charges the Dealer an acquisition fee. The acquisition fees associated with Contract purchases are deferred until the Contracts are sold, at which time the deferred acquisition fees are recognized as a component of the gain on sale. The Company also charges an origination fee for those Contracts that are sold on a flow basis. Those fees are recognized at the time the Contracts are sold and are also a component of the gain on sale.

*Investments*

The Company determines the appropriate classification of its investments in debt securities at the time of purchase. Debt securities for which the Company does not have the intent or ability to hold to maturity are classified as available for sale. Securities available for sale are carried at fair value, with unrealized gains and losses, net of tax, reported in a separate component of shareholders' equity as accumulated other comprehensive income.

The amortized cost of debt securities classified as available for sale is adjusted for amortization of premiums and accretion of discounts, over the estimated life of the security. Such amortization and interest earned on the debt securities are included in interest income.

*Flow Purchase Program*

The Company purchases Contracts for immediate and outright resale to non-affiliated third parties. The Company sells such Contracts for a mark-up above what the Company pays the Dealer. In such sales, the Company makes certain representations and warranties to the purchasers, normal in the industry, which relate primarily to the legality of the sale of the underlying motor vehicle and to the validity of the security interest that is being conveyed to the purchaser. These representations and warranties are generally similar to the representations and warranties given by the originating Dealer to the Company. In the event of a breach of such representations or warranties, the Company may incur liabilities in favor of the purchaser(s) of the Contracts and there can be no assurance that the Company would be able to recover, in turn, against the originating Dealer(s).

*Residual Interest in Securitizations and Gain on Sale of Contracts*

The Company has purchased Contracts with the primary intention of reselling them in securitization transactions as asset-backed securities. Although the Company has not been able to sell Contracts in a securitization transaction since December 1998, it does plan to securitize in the future, as to which there can be no assurance. The Company's securitization structure has been as follows: The securitizations are generally structured as follows: First, the Company sells a portfolio of Contracts to a wholly owned subsidiary ("SPS"), which has been established for the limited purpose of buying and reselling the Company's Contracts. The SPS then transfers the same Contracts to either a grantor trust or an owner trust (the "Trust"). The Trust in turn issues interest-bearing asset-backed securities (the "Certificates"), generally in a principal amount equal to the aggregate principal balance of the Contracts. The Company typically sells these Contracts to the Trust at face value and without recourse, except that representations and warranties similar to those provided by the Dealer to the Company are provided by the Company to the Trust. One or more investors purchase the Certificates issued by the Trust; the proceeds from the sale of the Certificates are then used to purchase the Contracts from the Company. The Company purchases a financial guaranty insurance policy, guaranteeing timely payment of principal and interest on the senior Certificates, from an insurance company (the "Certificate Insurer"). In addition, the Company provides a credit enhancement for the benefit of the Certificate Insurer and the investors in the form of an initial cash deposit to an account ("Spread Account") held by the Trust. The agreements governing the securitization transactions (collectively referred to as the "Securitization Agreements") require that the initial deposits to the Spread Accounts be supplemented by a portion of collections from the Contracts until the Spread Accounts reach specified levels, and then maintained at those levels. The specified levels are generally computed as a percentage of the principal amount remaining unpaid under the related Certificates. The specified levels at which the Spread Accounts are to be maintained will vary depending on the performance of the portfolios of Contracts held by the Trusts and on other conditions, and may also be varied by

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

agreement among the Company, the SPS, the Certificate Insurer and the trustee. Such levels have increased and decreased from time to time based on performance of the portfolios, and have also been varied by agreement. The specified levels applicable to the Company's sold pools increased significantly in 1998. Effective November 3, 1999, as applied to monthly measurement dates from September 1999 onward, the specified levels have decreased. See note 15 — "Liquidity".

At the closing of each securitization, the Company removes from its consolidated balance sheet the Contracts held for sale and adds to its consolidated balance sheet (i) the cash received and (ii) the estimated fair value of the ownership interest that the Company retains in Contracts sold. That retained interest (the "Residual") consists of (a) the cash held in the Spread Account and (b) the net interest receivables ("NIRs"). NIRs represent the estimated discounted cash flows to be received from the Trust in the future, net of principal and interest payable with respect to the Certificates, and certain expenses. The excess of the cash received and the assets retained by the Company over the carrying value of the Contracts sold, less transaction costs, equals the net gain on sale of Contracts recorded by the Company.

The Company allocates its basis in the Contracts between the Certificates and the Residuals retained based on the relative fair values of those portions on the date of the sale. The Company recognizes gains or losses attributable to the change in the fair value of the Residuals, which are recorded at estimated fair value and accounted for as "held-for-trading" securities. The Company is not aware of an active market for the purchase or sale of interests such as the Residuals; accordingly, the Company determines the estimated fair value of the Residuals by discounting the amount and timing of anticipated cash flows released from the Spread Account (the cash out method), using a discount rate that the Company believes is appropriate for the risks involved. For that valuation, the Company has used an effective discount rate of approximately 14% per annum.

The Company receives periodic base servicing fees for the servicing and collection of the Contracts. In addition, the Company is entitled to the cash flows from the Residuals that represent collections on the Contracts in excess of the amounts required to pay principal and interest on the Certificates, the base servicing fees, and certain other fees (such as trustee and custodial fees). At the end of each collection period, the aggregate cash collections from the Contracts are allocated first to the base servicing fees and certain other fees such as trustee and custodial fees for the period, then to the Certificateholders for interest at the pass-through rate on the Certificates plus principal as defined in the Servicing Agreements. If the amount of cash required for the above allocations exceeds the amount collected during the collection period, the shortfall is drawn from the Spread Account. If the cash collected during the period exceeds the amount necessary for the above allocations, and there is no shortfall in the related Spread Account, the excess is released to the Company or in certain cases is transferred to other Spread Accounts that may be below their required levels. Pursuant to certain Servicing Agreements, excess cash collected during the period is used to make accelerated principal paydowns on certain Certificates to create excess collateral (over-collateralization or OC account). If the Spread Account balance is not at the required credit enhancement level, then the excess cash collected is retained in the Spread Account until the specified level is achieved. The cash in the Spread Accounts is restricted from use by the Company. Cash held in the various Spread Accounts is invested in high quality, liquid investment securities, as specified in the Servicing Agreements. Spread Account balances are held by the Trusts on behalf of the Company as the owner of the Residuals.

The annual percentage rate payable on the Contracts is significantly greater than the pass through rate on the Certificates. Accordingly, the Residuals described above are a significant asset of the Company. In determining the value of the Residuals described above, the Company must estimate the future rates of prepayments, delinquencies, defaults and default loss severity as they affect the amount and timing of the estimated cash flows. The Company estimates prepayments by evaluating historical prepayment performance of comparable Contracts. The Company has used a constant prepayment estimate of approximately 4% per annum. The Company estimates defaults and default loss severity using available historical loss data for comparable Contracts and the specific characteristics of the Contracts purchased by the Company. In valuing the residuals, the Company estimates that losses as a percentage of the original principal balance will range from 14% to 17.0% cumulatively over the lives of the related Contracts.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In future periods, the Company would recognize additional revenue from the Residuals if the actual performance of the Contracts were to be better than the original estimate, or the Company would increase the estimated fair value of the Residuals. If the actual performance of the Contracts were to be worse than the original estimate, then a downward adjustment to the carrying value of the Residuals would be required.

The Certificateholders and the related securitization trusts have no recourse to the Company for failure of the Contract obligors to make payments on a timely basis. The Company's Residuals are subordinate to the Certificates until the Certificateholders are fully paid.

*Servicing*

The Company considers the servicing fee received to approximate adequate compensation. As a result, no servicing asset or liability has been recognized. Servicing fees are reported as income when earned. Servicing costs are charged to expense as incurred. Servicing fees receivable represent fees earned but not yet remitted to the Company by the trustee.

*Furniture and Equipment*

Furniture and equipment are stated at cost net of accumulated depreciation. The Company calculates depreciation using the straight-line method over the estimated useful lives of the assets which ranges 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.

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

The Company accounts for long-lived assets in accordance with the provisions of SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." This Statement requires that long-lived assets and certain identifiable intangibles be 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.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Earnings (Loss) per Share*

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

	<u>Year ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(in thousands, except per share data)		
Numerator:			
Numerator for basic earnings (loss) per share —			
net income (loss) .....	\$ (22,147)	\$ (44,532)	\$ 25,703
Interest on borrowings, net of tax effect on			
conversion of convertible subordinated debt.....	<u>—</u>	<u>—</u>	590
Numerator for diluted earnings (loss) per share .....	<u>\$ (22,147)</u>	<u>\$ (44,532)</u>	<u>\$ 26,293</u>
Denominator:			
Denominator for basic earnings (loss) per share —			
weighted average number of common shares			
outstanding during the year .....	20,195	18,678	15,412
Incremental common shares attributable to			
exercise of outstanding options and warrants.....	—	—	881
Incremental common shares attributable to			
conversion of subordinated debt .....	<u>—</u>	<u>—</u>	1,207
Denominator for diluted earnings (loss) per share .....	<u>20,195</u>	<u>18,678</u>	<u>17,500</u>
Basic earnings (loss) per share .....	<u>\$ (1.10)</u>	<u>\$ (2.38)</u>	<u>\$ 1.67</u>
Diluted earnings (loss) per share .....	<u>\$ (1.10)</u>	<u>\$ (2.38)</u>	<u>\$ 1.50</u>

Excluded from the diluted loss per share calculation for the year ended December 31, 2000, and 1999, were 1.7 million shares and 344,256 shares, respectively, from outstanding options and warrants, and for the year ended December 31, 2000, and 1999, an additional 2.4 million from incremental shares attributable to the conversion of certain subordinated debt, as these securities are anti-dilutive.

*Deferral and Amortization of Debt Issue Costs*

Costs related to the issuance of debt are amortized on a straight-line basis over the shorter of the actual or expected term of the related debt.

*Income Taxes*

The Company and its subsidiaries file a consolidated Federal income and combined state franchise tax returns. The Company utilizes the asset and liability method of accounting for income taxes, under which deferred income taxes are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts 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.

*Treasury Stock*

The Company records purchases of its own common stock at cost.

*Stock Option Plan*

As permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), the Company accounts for stock-based employee compensation plans in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

related interpretations. The Company provides the pro forma net income (loss), pro forma earnings per share, and stock based compensation plan disclosure requirements set forth in SFAS No. 123. The Company accounts for repriced options as variable awards.

*Segment Reporting*

Operations are managed and financial performance is evaluated on a Company wide basis by chief decision makers. Accordingly, all of the Company's operations are considered by management to be aggregated in one reportable operating segment.

*New Accounting Pronouncements*

In June 1998, the FASB issued Statement of Financial Accounting Standard No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 137 and SFAS No. 138 (collectively "SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be specifically designated as (a) a hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment, (b) a hedge of the exposure to variable cash flows of a forecasted transaction, or (c) a hedge of the foreign currency exposure of a net investment in foreign operations, an unrecognized firm commitment, an available for sale security, or a foreign-currency-denominated forecasted transaction.

Under SFAS No. 133, an entity that elects to apply hedge accounting is required to establish at the inception of the hedge the method it will use for assessing the effectiveness of the hedging derivative and the measurement approach for determining the ineffective aspect of the hedge. Those methods must be consistent with the entity's approach to managing risk. This statement is effective for the Company on January 1, 2001. On January 1, 2001, the Company adopted SFAS No. 133. The adoption of SFAS No. 133 did not have an effect on the Company.

In March 2000, the Financial Accounting Standards Board issued Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation — an interpretation of APB Opinion No. 25" ("FIN 44"). This Interpretation clarifies the definition of an employee for purposes of applying Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), the criteria for determining whether a plan qualifies as a noncompensatory plan, the accounting consequence of various modifications of a previously fixed stock option or award, and the accounting for an exchange of stock compensation awards in a business combination. This Interpretation is effective July 1, 2000, but certain conclusions in this Interpretation cover specific events that occur after either December 15, 1998 or January 12, 2000. During 2000, the Company recognized \$778,000 related to repriced options that were vested. The amount of compensation expense recognized in future periods will be affected by the Company stock price until all such options are either exercised or cancelled.

In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement for FASB Statement No. 125" ("SFAS 140"). The new statement, SFAS 140, revises the standards for accounting for securitizations and for other transfers of financial assets and collateral. SFAS 140 also requires certain disclosures that were not required under FASB Statement No. 125. The accounting provisions of SFAS 140 will apply to the Company for transfers of financial assets occurring after March 31, 2001, and the reclassification and disclosure provisions will apply to the Company for fiscal years ending after December 15, 2000. Because most of the provisions of FASB Statement No. 125 are carried over into SFAS 140 without change, the Company does not expect that the adoption and implementation of SFAS 140 will have a material effect on its results of operations or financial condition.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management 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 credit losses, deferred tax valuation allowance, valuing the Residuals and computing the related gain on sale on the transactions that created the Residuals. Actual results could differ from those estimates depending on the future performance of the related Contracts.

*Reclassification*

Certain amounts for the prior years have been reclassified to conform to the current year's presentation.

**(2) Restricted Cash**

Restricted cash comprised the following components:

	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	<b>(in thousands)</b>	
Flow purchases deposit	\$ 4,500	\$ —
LINC bankruptcy reserve .....	500	—
Interest reserve .....	—	1,684
Other.....	<u>264</u>	<u>350</u>
Total restricted cash .....	<u>\$ 5,264</u>	<u>\$ 2,034</u>

During 2000, the Company established agreements with third parties that purchase Contracts from the Company on a flow through basis, to expedite payment for Contracts that the Company sells to such purchasers. As part of the agreements, the Company agreed to post cash reserves to be used to pay for any Contracts not ultimately accepted by the respective third parties. As of the date of this report, no amounts have been drawn on either of the reserve accounts. The Company has the ability to cancel the agreements at any time and require that the reserve amounts be returned.

In connection with the bankruptcy of LINC, the court has ordered the Company to post a cash reserve. The Company continues to contest vigorously this matter (see note 10).

Restricted cash in the amount of \$1.7 million as of December 31, 1999, was required as part of the agreement related to a \$33.3 million senior secured line of credit established by the Company in April 1998 (see note 13). The agreement required the Company to post a cash reserve equal to the greater of \$1.0 million or six months of interest based on the outstanding balance of the line at the end of the month. During 2000, all amounts owed under the agreement were repaid in full and the agreement was terminated.

**(3) CONTRACTS HELD FOR SALE**

The following table presents the components of Contracts held for sale:

	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	<b>(in thousands)</b>	
Gross receivable balance .....	\$ 21,426	\$ 3,857
Unearned finance charges.....	(308)	(136)
Deferred acquisition fees and discounts	(121)	(437)
Allowance for credit losses.....	<u>(2,167)</u>	<u>(863)</u>
Net contracts held for sale .....	<u>\$ 18,830</u>	<u>\$ 2,421</u>

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the activity in the allowance for credit losses:

	<b>Year ended December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
	(in thousands)		
Balance, beginning of year.....	\$ 863	\$ 2,751	\$ 2,204
Provisions.....	1,838	5,323	3,544
Charge-offs.....	(4,286)	(8,478)	(2,535)
Allowance allocated (to) reclassified from repossessed inventory and contracts held to maturity.....	1,136	(217)	(1,349)
Recoveries.....	<u>2,616</u>	<u>1,484</u>	<u>887</u>
Balance, end of year.....	<u>\$ 2,167</u>	<u>\$ 863</u>	<u>\$ 2,751</u>

The Company is required to represent and warrant certain matters with respect to the Contracts used as collateral in warehouse lines of credit, which generally duplicate the substance of the representations and warranties made by the Dealers in connection with the Company's purchase of the Contracts. In the event of a breach by the Company of any representation or warranty, the Company is obligated to repurchase the Contracts from the investors at a price equal to the investors' purchase price less the related credit enhancement and any principal payments received from the obligor. In most cases, the Company would then be entitled under the terms of its agreements with Dealers to require the selling Dealer to repurchase the Contracts at the Company's purchase price less any principal payments received from the obligor.

For the year ended December 31, 2000, 12.8% and 12.2% of Contracts purchased by the Company were purchased from Dealers in California and Texas, respectively. For the year ended December 31, 1999, 15.2% and 8.1% of Contracts purchased by the Company were purchased from Dealers in California and Texas, respectively

As of December 31, 2000 and 1999, respectively, the Company had commitments to purchase \$2.4 million and \$1.7 million of Contracts from Dealers in the ordinary course of business.

**(4) Residual Interest in Securitizations**

The following table presents the components of the residual interest in securitizations:

	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	(in thousands)	
Cash, commercial paper, US government securities and other qualifying investments (Spread Account).....	\$ 60,554	\$ 126,126
Receivable from Trusts.....	38,639	46,288
Investment in subordinated certificates .....	<u>6</u>	<u>116</u>
Residual interest in securitizations .....	<u>\$ 99,199</u>	<u>\$ 172,530</u>

The following table presents the estimated remaining undiscounted credit losses included in the fair value estimate of the Residuals as a percentage of the Company's servicing portfolio subject to recourse provisions:

	<b>December 31,</b>		
	<b>2000</b>	<b>1999</b>	<b>1998</b>
	(in thousands)		
Undiscounted estimated credit losses .....	\$ 17,819	\$ 77,480	\$ 169,110
Servicing subject to recourse provisions .....	<u>\$ 389,602</u>	<u>\$ 813,061</u>	<u>\$ 1,362,801</u>
Undiscounted estimated credit losses as percentage of servicing subject to recourse provisions.....	<u>4.57%</u>	<u>9.53%</u>	<u>12.41%</u>

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company did not securitize any Contracts in 2000 and 1999. The key economic assumptions used in measuring retained interest at the date of securitization during the year ended December 31, 1998, were as follows:

Prepayment speed (per annum) .....	4.00%
Weighted average life (in years) .....	2.1
Expected credit losses (cumulative) .....	14.0% - 14.3%
Residual cash flows discounted at (per annum) .....	14.0%

Static pool losses are calculated by summing the actual and projected future credit losses and dividing them by the original balance of each pool of assets. Static pool losses used to measure the 1998 retained interest for each subsequent year ranged from 14.3% to 14.8% and 14.0% to 15.3% at December 31, 1999 and 2000, respectively.

Of the key economic assumptions used in measuring all retained interests remaining as of December 31, 2000, and 1999, prepayment speed, and the discount rate remained constant. The range of net credit losses used in measuring all retained interests as of December 31, were as follows:

	<u>2000</u>	<u>1999</u>
Actual and projected credit losses.....	14.0 - 17.0%	14.0 - 16.5%

Key economic assumptions and the sensitivity of the current fair value of residual cash flows to immediate 10 percent and 20 percent adverse changes in those assumptions are as follows:

	<u>December 31, 2000</u> <u>(in thousands,</u> <u>except years)</u>
Carrying amount/fair value of residual interest in securitizations .....	\$ 99,199
Weighted average life in years .....	1.0
Prepayment Speed Assumption (Annual Rate) .....	4.0%
Effect on fair value of 10% adverse change .....	99,123
Effect on fair value of 20% adverse change .....	99,049
Expected Credit Losses (Annual Rate) .....	4.6%
Effect on fair value of 10% adverse change .....	97,417
Effect on fair value of 20% adverse change .....	95,635
Residual Cash Flows Discount Rate (Annual) .....	14.0%
Effect on fair value of 10% adverse change .....	97,648
Effect on fair value of 20% adverse change .....	96,130

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in fair value based on 10 percent variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another (for example, increases in market rates may result in lower prepayments and increased credit losses), which could magnify or counteract the sensitivities.

The following table summarizes the cash flows received from (paid to) securitization trusts:

	<u>For the Year Ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	<u>(in thousands)</u>		
Releases of cash from Spread Accounts .....	\$ 80,614	\$ 27,974	\$ 16,075
Servicing fees received .....	15,840	26,719	25,098
Net deposits to Spread Accounts .....	(15,042)	(23,093)	(77,595)
Purchase of delinquent or foreclosed assets .....	(83,246)	(123,158)	(92,544)
Repurchase of trust assets .....	(24,535)	—	—

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table presents the historical loss and delinquency amounts for the serviced portfolio:

	<u>Total Principal Amount of Contracts</u>		<u>Principal Amount of Contracts 60 Days or More Past Due</u>		<u>Net Credit Losses For the Year Ended December 31,</u>	
	<u>At December 31,</u>				<u>2000</u>	<u>1999</u>
	<u>2000</u>	<u>1999</u>	<u>2000</u>	<u>1999</u>	<u>2000</u>	<u>1999</u>
	(in thousands)					
Securitized Contracts.....	\$ 389,602	\$ 813,061	\$ 7,115	\$ 15,872	\$ 62,954	\$ 104,956
Contracts held for sale.....	21,452	4,833	649	1,349	230	3,483
Contracts held to maturity.....	829	3,085	163	1,516	1,440	3,511
Total servicing portfolio.....	<u>\$ 411,883</u>	<u>\$ 820,979</u>	<u>\$ 7,927</u>	<u>\$ 18,737</u>	<u>\$ 64,624</u>	<u>\$ 111,950</u>

Notes:

(1) Contracts 60 days or more past due are based on end of period totals.

**(5) Gain (Loss) On Sale of Contracts**

The following table presents the components of the net gain (loss) on sale of Contracts:

	<u>Year ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(in thousands)		
NIR gains recognized.....	\$ —	\$ —	\$ 52,990
Gain (loss) on sale of Contracts.....	18,352	(15,831)	—
Deferred acquisition fees and discounts	162	7,434	23,330
Provision for loss on NIRs.....	—	—	(7,762)
Expenses related to sales.....	(442)	(1,124)	(6,708)
Provision for credit losses.....	(1,838)	(5,323)	(3,544)
Net gain (loss) on sale of Contracts.....	<u>\$ 16,234</u>	<u>\$ (14,844)</u>	<u>\$ 58,306</u>

**(6) Interest Income**

The following table presents the components of interest income:

	<u>Year ended December 31,</u>		
	<u>2000</u>	<u>1999</u>	<u>1998</u>
	(in thousands)		
Interest on Contracts held for sale	\$ 1,956	\$ 27,802	\$ 42,667
Residual interest income, net.....	653	(24,917)	(1,652)
Other interest income.....	871	147	826
	<u>\$ 3,480</u>	<u>\$ 3,032</u>	<u>\$ 41,841</u>

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(7) Furniture and Equipment**

The following table presents the components of furniture and equipment:

	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	<b>(in thousands)</b>	
Furniture and fixtures.....	\$ 3,001	\$ 3,000
Computer equipment.....	2,732	2,378
Leasing assets.....	820	882
Leasehold improvements.....	637	637
Other fixed assets.....	233	34
	7,423	6,931
Less accumulated depreciation and amortization	(4,864)	(3,891)
	<b>\$ 2,559</b>	<b>\$ 3,040</b>

**(8) Related Party Transactions**

*Investment in Unconsolidated Affiliates*

Investment in unconsolidated affiliates primarily consists of a 38% interest in NAB Asset Corporation (“NAB”) that was acquired by the Company on June 6, 1996, for approximately \$4.3 million. At the time of the acquisition, NAB had approximately \$3.5 million in cash and no significant operations. The Company’s purchase price of its investment in NAB exceeded the Company’s share of the net assets of NAB at the acquisition date by approximately \$1.4 million. This amount, which was included in other assets in the accompanying consolidated balance sheets as goodwill, was being amortized over a period of fifteen years. During 1999, the Company determined that the value of the goodwill was impaired and wrote off the remaining balance of the goodwill which is included in other income (loss) in the accompanying consolidated statement of operations. Based on the closing price on the Nasdaq, the market value of the investment in NAB was approximately \$39,000, \$483,674 and \$2.9 million at December 31, 2000, 1999 and 1998, respectively. Charles E. Bradley, Sr., Chairman of the Company’s Board of Directors and a principal shareholder of the Company, and Charles E. Bradley, Jr., President, Chief Executive Officer and a member of the Company’s Board of Directors, are both members of the Board of Directors of NAB.

Subsequent to the Company’s investment in NAB, NAB purchased Mortgage Portfolio Services, Inc. (“MPS”) from the Company for \$300,000. MPS, formed by the Company in April 1996, is a mortgage broker-dealer based in Texas. In July 1996, NAB formed CARSUSA, Inc. (“CARSUSA”), which purchased, and now owns and operates, a Mitsubishi automobile dealership in Southern California. On June 27, 1997, NAB sold CARSUSA to Charles E. Bradley, Sr. and Charles E. Bradley, Jr., for \$1.5 million. Included in other income for the years ended December 31, 2000, 1999 and 1998, is a loss of \$755,081 and \$2.5 million and income of \$51,593, respectively, which represents the Company’s share of NAB’s net income or loss.

*Related Party Receivables*

The following table presents the components of related party receivables:

<b><u>Related Party</u></b>	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	<b>(in thousands)</b>	
CARSUSA, Inc. ....	\$ 688	\$ 690
Loan to Officer of Subsidiary.....	125	125
NAB Asset Corporation.....	86	86
	<b>\$ 899</b>	<b>\$ 901</b>

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During 2000 and 1999, Company sold 0 and 11 repossessed automobiles to CARSUSA and received proceeds of \$0 and \$83,800, respectively. Additionally, the Company purchased 28 and 57 Contracts from CARSUSA, with an aggregate principal balance of approximately \$414,052 and \$827,434 respectively, in 2000 and 1999.

During 1997, the Company lent a total of \$9.5 million to NAB, represented by two promissory notes for \$5.5 million and \$4.0 million, each bearing interest at 13% annually. On December 31, 1997, Stanwich Financial Services Corp. ("SFSC") purchased the \$4.0 million note at par. Charles E. Bradley, Sr., Charles E. Bradley, Jr., and John G. Poole, who are officers and directors of the Company, collectively owned all of the common stock of Stanwich Holdings, Inc. ("Stanwich Holdings"), and Mr. Bradley, Sr., is the president and a director of Stanwich Holdings. SFSC is a wholly-owned subsidiary of Stanwich Holdings. NAB repaid approximately \$3.4 million of the \$5.5 million promissory note during 1998, and the balance during 1999.

At December 31, 1998, the Company was owed \$139,229 by Service and Management Cooperative, Inc. This was written off in 1999 and is included in other income (loss). These amounts represent liabilities incurred by Service and Management Cooperative, Inc., which were paid for by the Company. Certain officers of the Company's subsidiary Samco were officers of Service and Management Cooperative, Inc.

In July 1998, the president of SAMCO borrowed \$125,000 from the Company. The loan bears interest at the rate of 10% per annum and is due July 2001.

The Company was a party to a consulting agreement with Stanwich Partners, Inc., that called for monthly payments of \$6,250 through December 31, 1999. Stanwich Partners, Inc., is an affiliate of Charles E. Bradley, Sr. Included in the accompanying consolidated statements of operations for the years ended December 31, 2000, 1999 and 1998, is \$12,500, \$75,000 and \$75,000, respectively, of consulting expense related to this consulting agreement.

In November 1998, the Company issued \$25 million of subordinated promissory notes due November 30, 2003, to an affiliate of Levine Leichtman Capital Partners, Inc. ("LLCP") (see note 13). As part of the transaction, the Company entered into a consulting agreement with LLCP, calling for monthly consulting fees of \$22,917 through November 1999. Included in the accompanying consolidated statements of operations for the years ended December 31, 2000, and 1999, are \$0 and \$252,083 respectively, of consulting fees related to this consulting agreement.

*Related Party Debt*

In June 1997 the Company borrowed \$15 million on an unsecured and subordinated basis from SFSC. This loan ("RPL") is due 2004, and has a fixed rate of interest of 9% per annum, payable monthly beginning July 1997. The Company may pre-pay the RPL without penalty at any time after three years. At maturity or repayment of the RPL, the holder thereof will have an option to convert 20% of the principal amount into common stock of the Company, at a conversion rate of \$11.86 per share. The balance of the RPL at December 31, 2000 and 1999, was \$15 million.

During 1998, the Company borrowed an additional \$4 million on an unsecured basis from SFSC. This loan ("RPL2") is due 2004, and has a fixed rate of interest of 12.5% per annum payable monthly beginning December 1998. The Company may pre-pay the RPL2, without penalty, at any time after June 12, 2000. At maturity or repayment of the RPL2, the holder thereof will have the option to convert the entire principal balance of the note, or a portion thereof, into common stock of the Company, at a conversion rate of \$3 per share. The balance of the RPL2 at December 31, 2000 and 1999 was \$4 million.

During 1998, the Company borrowed \$1 million on an unsecured basis from John G. Poole, a director of the Company. The terms of this note ("RPL3") are the same as RPL2. The balance of the RPL3 at December 31, 2000 and 1999 was \$1 million.

During 1999, the Company borrowed \$1.5 million on an unsecured basis from SFSC. This loan ("RPL4") is due 2004, has a fixed rate of interest of 14.5% per annum payable monthly beginning October 1999. In conjunction with

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

the issuance of RPL4, the Company issued warrants to purchase 103,500 shares of the Company's common stock at a price of \$0.01 per share.

*Related Party Stock Sale and Purchase*

In July 1998, the Company sold 443,459 shares of common stock in a private placement to SFSC for \$5 million. As of December 31, 2000, such shares of common stock had not been registered for public sale.

In December 2000, the Company purchased 315,152 shares of common stock from SFSC for \$624,000, or \$1.98 per share.

**(9) Shareholders' Equity**

*Common Stock*

Holders of the common stock are entitled to such dividends as the Company's 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.

The Company is required to comply with various operating and financial covenants defined in the agreements governing the warehouse lines, senior debt, subordinated debt, and related party debt. The covenants restrict the payment of certain distributions, including dividends. (See note 13 — "Debt.")

Included in common stock at December 31, 2000, is additional paid in capital related to the valuation of certain stock options as required by FIN 44. Based on the adoption of FIN 44, common stock increased by \$1.5 million, of which \$778,000 relates to the expense of currently vested options and \$734,000 relates to deferred compensation for unvested options.

*Stock Repurchases*

During 2000, the Company's board of directors authorized the Company to repurchase up to \$5 million in Company securities. During 2000, the Company repurchased 720,752 shares of common stock for approximately \$1.3 million, or an average of \$1.79 per share.

*Options and Warrants*

In 1991, the Company adopted and its sole shareholder approved the 1991 Stock Option Plan (the "1991 Plan") pursuant to which the Company's Board of Directors may grant stock options to officers and key employees. The Plan, as amended, authorizes grants of options to purchase up to 2,700,000 shares of authorized but unissued common stock. Stock options are granted with an exercise price equal to the stock's fair market value at the date of grant. Stock options have terms that range from 7 to 10 years and vest over a range of 0 to 7 years. In addition to the 1991 Plan, in fiscal 1995, the Company granted 60,000 options to certain directors of the Company that vest over three years and expire nine years from the grant date.

In July 1997, the Company adopted and its shareholders approved the 1997 Long-Term Incentive Plan (the "1997 Plan") pursuant to which the Company's Board of Directors may grant stock options, restricted stock and stock appreciation rights to employees, directors or employees of entities in which the Company has a controlling or significant equity interest. Options that have been granted under the 1997 Plan have in all cases been granted at an exercise price equal to the stock's fair market value at the date of the grant, with terms of 10 years and vesting over

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5 years. The 1997 Plan provides that an aggregate maximum of 1,500,000 shares of the Company's common shares may be subject to awards under the 1997 Plan.

In October 1998, the Company's Board of Directors approved a plan to cancel and reissue certain stock options previously granted to key employees of the Company. All options granted prior to October 22, 1998, with an option price greater than \$3.25 per share, were repriced to \$3.25 per share. In conjunction with the repricing, a one year period of non-exercisability was placed on all repriced options, which period ended on October 21, 1999.

In October 1999, the Company's Board of Directors approved a plan to cancel and reissue certain stock options previously granted to key employees of the Company. All options granted prior to October 29, 1999, with an option price greater than \$0.625 per share, were repriced to \$0.625 per share. In conjunction with the repricing, a six month period of non-exercisability was placed on all repriced options, which period ended on April 29, 2000.

At December 31, 2000, there were a total of 471,767 additional shares available for grant under the 1991 Plan and 1997 Plan. Of the options outstanding at December 31, 2000, 1999 and 1998, 1,532,590, 24,800, and 194,040, respectively, were then exercisable, with weighted-average exercise prices of \$0.63, \$0.69, and \$2.68, respectively. The per share weighted-average fair value of stock options granted during the years ended December 31, 2000, 1999 and 1998, was \$2.74, \$1.11, and \$1.87, respectively, at the date of grant. That fair value was computed using the Black-Scholes option-pricing model with the following weighted average assumptions:

	Year ended December 31,		
	2000	1999	1998
Expected life (years) .....	6.50	6.09	6.41
Risk-free interest rate .....	6.05%	5.96%	4.95%
Volatility .....	278.98%	114.79%	20.00%
Expected dividend yield.....	—	—	—

Compensation cost has been recognized for stock options in the consolidated financial statements in accordance with APB Opinion No. 25. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under Statement of Financial Accounting Standards No. 123, "Accounting for Stock Based Compensation," the Company's net income (loss) and net earnings per share would have been reduced to the pro forma amounts indicated below.

	Year ended December 31,		
	2000	1999	1998
	(in thousands, except per share data)		
Net income (loss)			
As reported.....	\$ (22,147)	\$ (44,532)	\$ 25,703
Pro forma .....	\$ (22,995)	\$ (46,236)	\$ 24,639
Net earnings (loss) per share — basic			
As reported.....	\$ (1.10)	\$ (2.38)	\$ 1.67
Pro forma .....	\$ (1.14)	\$ (2.48)	\$ 1.60
Net earnings (loss) per share — diluted			
As reported.....	\$ (1.10)	\$ (2.38)	\$ 1.50
Pro forma .....	\$ (1.14)	\$ (2.48)	\$ 1.48

Pro forma net income (loss) and net earnings (loss) per share reflect only options granted in the years ended December 31, 2000, 1999, 1998, 1997, and 1996. Therefore, the full impact of calculating compensation cost for stock options under SFAS No. 123 is not reflected in the pro forma amounts presented above, because compensation cost is reflected over the options' vesting period and compensation cost for options granted prior to April 1, 1995, is not considered.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Stock option activity during the periods indicated is as follows:

	Number of Shares	Weighted-Average Exercise Price
	(in thousands, except per share data)	
Balance at December 31, 1997	1,393	\$ 7.05
Granted.....	3,529	5.44
Exercised.....	5	8.50
Canceled.....	<u>2,412</u>	<u>8.64</u>
Balance at December 31, 1998	2,505	3.25
Granted.....	3,935	1.28
Exercised.....	—	—
Canceled.....	<u>3,448</u>	<u>3.27</u>
Balance at December 31, 1999	2,992	0.64
Granted.....	833	1.70
Exercised.....	53	0.63
Canceled.....	<u>291</u>	<u>1.01</u>
Balance at December 31, 2000	<u>3,481</u>	<u>\$ 0.86</u>

At December 31, 2000, the range of exercise prices, the number, weighted-average exercise price and weighted-average remaining term of options outstanding and the number and weighted-average price of options currently exercisable are as follows:

Options Outstanding			Options Exercisable		
Range of Exercise Prices (per share)	Number Outstanding	Weighted- Average Remaining Term (in thousands, except term and per share data)	Weighted Average Exercise Price Per Share	Number Exer- cisable	Weighted Average Exercise Price Per Share
\$ 0.63 - \$ 0.63 .....	2,698	6.25	\$ 0.63	1,530	\$ 0.63
\$ 0.69 - \$ 1.88 .....	783	9.67	\$ 1.68	3	\$ 0.90

On November 17, 1998, in conjunction with the issuance of a \$25.0 million subordinated promissory note to an affiliate of LLCP, the Company issued warrants to purchase up to 3,450,000 shares of common stock at \$3.00 per share, exercisable through November 30, 2005. In April 1999, in conjunction with the issuance of \$5.0 million of an additional subordinated promissory note to an affiliate of LLCP, the Company issued additional warrants to purchase 1,335,000 shares of the Company's common stock at \$0.01 per share to LLCP. As part of the purchase agreement, the existing warrants to purchase 3,450,000 shares at \$3.00 per share were exchanged for warrants to purchase 3,115,000 shares at a price of \$0.01 per share. The aggregate value of the warrants, \$12.9 million, which is comprised of \$3.0 million from the original warrants issued in November 1998 and \$9.9 million from the repricing and additional warrants issued in April 1999, is reported as deferred interest expense to be amortized over the expected life of the related debt, five years. As of December 31, 2000, 1,000 warrants remained unexercised. As of December 31, 2000, the remaining warrants, and the common stock issued in conjunction with the exercise of 4,449,000 of warrants had not been registered for public sale. However, the holder of the remaining warrants has the right to require the Company register the warrants and common stock for public sale in the future.

Also in November 1998, the Company entered into an agreement with the Certificate Insurer of its asset-backed securities. The agreement commits the Certificate Insurer to provide insurance for the securitization of \$560.0 million in asset-backed securities, of which \$250.0 million remained at December 31, 1998. The agreement provides for a 3% initial Spread Account deposit. As consideration for the agreement, the Company issued warrants to purchase up to 2,525,114 shares of common stock at \$3.00 per share, subject to anti-dilution adjustments. The warrants are fully exercisable on the date of grant and expire in November 2003. The value of the warrants, \$2.2 million, is included in other assets as deferred securitization expense to be amortized over five years. As of

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

December 31, 2000, the warrants had not been registered for public sale. However, the holder of the warrants has the right to require the Company to register the warrants for public sale in the future.

**(10) Commitments and Contingencies**

*Leases*

The Company leases its facilities and certain computer equipment under non-cancelable operating and capital leases, which expire through 2009. Future minimum lease payments at December 31, 2000, under these leases are as follows:

	<u>Capital</u>	<u>Operating</u>
	(in thousands)	
2001.....	\$ 597	\$ 2,822
2002.....	428	2,725
2003.....	70	2,709
2004.....	—	2,570
2005.....	—	2,572
Thereafter.....	—	6,803
 Total minimum lease payments.....	 1,095	 <u>\$ 20,201</u>
 Less: amount representing interest.....	 113	
 Present value of net minimum lease payments.....	 <u>\$ 982</u>	

Included in furniture and equipment in the accompanying consolidated balance sheets are the following assets held under capital leases at December 31, 2000:

Furniture and fixtures.....	\$ 2,044
Computer equipment.....	76
	2,120
Less: accumulated depreciation.....	1,266
	<u>\$ 854</u>

Rent expense for the years ended December 31, 2000, 1999 and 1998, was \$3.2 million, \$3.1 million, and \$2.0 million, respectively. The Company's facility lease contains 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 term of the lease.

In November 1998, the Company entered into a sublease agreement for the space that had been the Company's headquarters in Irvine, California. The sublease agreement extends beyond the term of the lease and provides for the tenant to pay a base rent in excess of the lease payment required of the Company, plus all common area maintenance charges and property taxes. During 2000 and 1999, the Company received \$968,920 and \$875,215, respectively, of sublease income, which is included in occupancy expenses. Future minimum sublease payments totaled \$330,486 at December 31, 2000.

*Litigation*

On October 29, 1999, three ex-employees of LINC filed an involuntary petition under Chapter 7 of the Bankruptcy Code, naming LINC as the debtor, and seeking its liquidation. The petition was filed in the U.S. Bankruptcy Court for the District of Connecticut. Among the allegations asserted against the Company is that LINC

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

is entitled to a retained interest in the Contracts sold by LINC in securitizations, and thus to a share of the distributions from the securitized pools. The Company intends to contest vigorously this matter.

On May 12, 2000, Jon L. Kunert and Penny Kunert commenced a lawsuit against an automobile dealer, the Company and in excess of 20 other defendants in the Superior Court of California, Los Angeles County. The defendants other than the automobile dealer appear to be various entities (“finance defendants”) that may have purchased retail installment contracts from that dealer. The lawsuit alleges that the various finance defendants conspired with the automobile dealer defendant to conceal from motor vehicle purchasers the full cost of credit applicable to their purchases, and seeks a refund of the concealed excess cost. The court has ordered the plaintiffs to file separate lawsuits against each finance defendant. As of the date of this report, the Company is not aware that any such lawsuit has been filed. The Company intends to contest vigorously any such lawsuit, when and if it is filed.

On August 15, 2000, Linda McGee filed a lawsuit in the New Jersey Circuit Court of Gloucester County alleging that she, and a purported 48-state class, were defrauded by a “conspiracy” among the Company and unspecified automobile dealers. The alleged object of the conspiracy was to conceal from plaintiff the minimum interest rate at which the Company would be willing to finance a vehicle purchase, and thus to gain for the dealer the additional amount that the Company is willing to pay for higher-rate Contracts. The complaint seeks damages in an unspecified amount. The 48-state class alleged by plaintiff is defined to exclude the states of Alabama and Tennessee, where similar lawsuits against other auto finance companies have failed.

On November 15, 2000, Denice and Gary Lang filed a lawsuit in South Carolina Common Pleas Court, Beaufort County, alleging that they, and a purported nationwide class, were harmed by an alleged failure to refer, in the notice given after repossession of their vehicle, of the right to purchase the vehicle by tender of the full amount owed under the retail installment contract. They seek damages in an unspecified amount.

Approximately 12 plaintiffs have filed seven lawsuits against approximately 50 defendants, all arising out of the failure of Stanwich Financial Services Corp. (“SFSC”) to make certain payments when due in November 2000. The defendants include SFSC, numerous financial institutions, Charles Bradley, Sr., Charles Bradley, Jr. and the Company. The five lawsuits that name the Company as a defendant allege, in essence, that the Company acted as the alter-ego of Charles Bradley, Sr. in connection with the acquisition of SFSC by a corporation controlled by Mr. Bradley, and that Mr. Bradley wrongfully caused SFSC to not pay its obligations to the plaintiffs. Among the acts alleged to be wrongful are the actions of SFSC in lending the Company an aggregate of \$20.5 million. Since the filing of the first such lawsuit, the Company has prepaid to SFSC \$4 million of such indebtedness. As of the date of this report, the Company has not been required to respond to any of the seven lawsuits, and is in the process of retaining counsel to appear on its behalf. The Company intends to contest vigorously this litigation.

It is management’s opinion, based on the advice of counsel, that all litigation of which it is aware, including the matters discussed above, will not have a material adverse effect on the Company’s consolidated financial position, results of operations or liquidity, beyond reserves already taken.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(11) Income Taxes**

Income taxes consist of the following:

	<b>Year ended December 31,</b>		
	<b>2000</b>	<b>1999</b> <b>(in thousands)</b>	<b>1998</b>
Current:			
Federal.....	\$ —	\$ (3,450)	\$ 3,318
State.....	—	—	1,195
	<u>—</u>	<u>(3,450)</u>	<u>4,513</u>
Deferred:			
Federal.....	(10,458)	(17,926)	10,451
State.....	(3,466)	(6,255)	3,653
Valuation allowance.....	3,668	—	—
	<u>—</u>	<u>(24,181)</u>	<u>14,104</u>
Income taxes (benefit).....	<u>\$ (10,256)</u>	<u>\$ (27,631)</u>	<u>\$ 18,617</u>

The Company's effective tax expense benefit for the years ended December 31, 2000, 1999 and 1998, differs from the amount determined by applying the statutory federal rate of 35% to income (loss) before income taxes as follows:

	<b>Year ended December 31,</b>		
	<b>2000</b>	<b>1999</b> <b>(in thousands)</b>	<b>1998</b>
Expense (benefit) at federal tax rate.....	\$ (11,341)	\$ (25,258)	\$ 15,512
California franchise tax, net of federal income tax benefit.....	(2,253)	(4,066)	3,151
Other.....	(330)	1,693	(46)
Valuation allowance.....	3,668	—	—
	<u>\$ (10,256)</u>	<u>\$ (27,631)</u>	<u>\$ 18,617</u>

The tax affected cumulative temporary differences that give rise to deferred tax assets and liabilities as of December 31, 2000 and 1999, are as follows:

	<b>December 31,</b>	
	<b>2000</b>	<b>1999</b>
	<b>(in thousands)</b>	
Deferred Tax Assets:		
Accrued liabilities.....	\$ 1,815	\$ 1,239
Furniture and equipment.....	210	233
Equity investment.....	751	434
NOL Carryforward.....	11,031	9,624
Minimum tax credit.....	334	334
Other.....	465	123
Total deferred tax assets.....	<u>14,606</u>	<u>11,987</u>
Valuation allowance.....	<u>(3,668)</u>	<u>—</u>
	10,938	11,987
Deferred Tax Liabilities:		
NIRs.....	(1,856)	(8,168)
Provision for credit losses.....	(1,158)	(6,140)
Federal impact of state NOL carryforward.....	(735)	(746)
Total deferred tax liabilities.....	<u>(3,749)</u>	<u>(15,054)</u>
Net deferred tax asset (liability).....	<u>\$ 7,189</u>	<u>\$ (3,067)</u>

As of December 31, 2000, the Company has net operating loss carry-forwards for federal and state income tax purposes of \$25.5 million and \$20.0 million, respectively, which are available to offset future taxable income, if any,

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

through 2020 and 2010, respectively. In addition, the Company has an alternative minimum tax credit carry-forward of approximately \$334,000 which is available to reduce future federal regular income taxes, if any, over an indefinite period.

As of December 31, 2000, the Company has estimated a valuation allowance against the deferred tax asset of \$3.7 million as it is not more than likely that the amounts will be utilized in the future. However, the Company believes that the remaining deferred tax asset will more likely than not be realized due to the reversal of the deferred tax liability and the expected future taxable income. In determining the possible future realization of deferred tax assets, future taxable income from the following sources are taken into account: (a) reversal of taxable temporary differences, (b) future operations exclusive of reversing temporary differences, and (c) tax planning strategies that, if necessary, would be implemented to accelerate taxable income into years in which net operating losses might otherwise expire. The realization of the net deferred tax asset is dependent on material improvements over present levels of consolidated pre-tax income. Cumulative sources of taxable income must reach approximately \$17.5 million during the tax net operating loss carryforward period, which management anticipates achieving in an 18 to 24 month period. Management anticipates improvements in pre-tax income due to significant increases in loan originations held for sale and the resumption of securitization transactions in the second quarter of 2001. However, due to uncertainty surrounding the ability of the Company to achieve future pre-tax income beyond this time frame, management has established a valuation allowance, for remaining net deferred tax assets. Although realization is not assured, management believes it is more likely than not that the recognized net deferred tax assets will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

The Company files its tax returns on a fiscal year ending March 31. During 1998, the Company's federal income tax return for the tax year ended March 31, 1995, was audited by the Internal Revenue Service. As a result of the audit, the Company was required to pay approximately \$150,000 in payroll taxes and interest. The audit was concluded and closed during 1998.

**(12) Debt**

In November 2000, the Company entered into a revolving note purchase facility under which up to \$75 million of notes may be outstanding at any time subject to a collateral test and other conditions. The Company uses funds derived from this facility to purchase Contracts, which are pledged to secure the Notes. The collateral test generally allows the Company to borrow up to approximately 75% of the price paid for such Contracts. Notes issued under this facility bear interest at one-month LIBOR plus 0.30% per annum, which rate was 6.56% at December 31, 2000. As of December 31, 2000, the balance outstanding under this facility was \$2.0 million.

In November 1998, the Company entered into a warehouse line of credit agreement with General Electric Capital Corporation (the "GECC Line"). The GECC Line provided for warehouse facility advances up to a maximum of \$100 million at a variable interest rate of LIBOR + 3.75% (8.87% at December 31, 1998). The GECC Line by its terms was to expire November 30, 1999. During 1999, the Company defaulted on the GECC Line agreements and was required to repay all balances owed. During August 1999, all amounts owed under the GECC Line were repaid and the agreement was terminated.

In November 1997, the Company entered into a warehouse line of credit agreement with First Union Capital Markets ("First Union Line"). The First Union Line provided for a maximum of \$150.0 million of advances to the Company, with interest at a variable rate indexed to prevailing commercial paper rates. In July 1998, the advance amount was increased to \$200.0 million. In conjunction with the increase in maximum advance amount under the agreement, the expiration date was changed to July 31, 1999, renewable for one year with the mutual consent of the Company and First Union Capital Markets. During 1999, the Company defaulted on the First Union Line agreement and was required to repay the balance outstanding in its entirety. In June 1999, the balance of the First Union Line was repaid in its entirety and the related agreement was terminated.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In December 1996, the Company entered into an overdraft financing facility, with a bank, that provided for maximum borrowings of \$2.0 million. Interest was charged on the outstanding balance at the bank's reference rate plus 1.75%. During 1997, the overdraft facility was increased to \$4.0 million. There were no borrowings outstanding under this facility at December 31, 1998. During 1999, the Company defaulted under the overdraft facility and was required to repay the outstanding balance in its entirety. In November 1999, the remaining balance outstanding under the overdraft facility was repaid in its entirety and the related agreement was terminated.

In April 1998, the Company established a \$33.3 million senior secured credit line (the "Senior Secured Line") with State Street Bank and Trust Company, Prudential Insurance and an affiliate of Prudential. Borrowings under the Senior Secured Line were secured by all the Company's assets, including its residual interest in securitizations. The Senior Secured Line was a revolving facility for one year, after which it converted into a loan with a maximum term of four years. The lenders under the Senior Secured Line declared a default in August 1999, and in November 1999 reached an agreement with the Company under which such lenders agreed to refrain from exercising their remedies occasioned by such default, and under which the Company and such lenders agreed to a repayment schedule with respect to all indebtedness under the senior secured loan. As part of the agreement to restructure the repayment schedule of the senior secured loan, the interest rate was increased from LIBOR + 4% to LIBOR + 5%. At December 31, 1999, the balance outstanding under the Senior Secured Line was \$23.2 million. In March 2000, all amounts owed under the Senior Secured Line were paid in full and the agreement was terminated. Proceeds used to repay the balance owed under the Senior Secured Line were obtained as a result of restructuring certain subordinated debt as discussed below.

In November 1998, the Company issued \$25.0 million of subordinated promissory notes due November 30, 2003, to an affiliate of Levine Leichtman Capital Partners, Inc. ("LLCP"), and received the proceeds (net of \$1.3 million of capitalized issuance costs), of approximately \$23.7 million. The Company also issued warrants to purchase up to 3,450,000 shares of common stock at \$3.00 per share, exercisable through November 30, 2005 (see note 10). The debt bears interest at 13.5% per annum, and may not be prepaid without penalty prior to November 1, 2002. Simultaneously with the consummation of that transaction, certain affiliates of the Company, who had lent the Company an aggregate of \$5.0 million on a short-term basis in August and September 1998, agreed to subordinate their indebtedness to the indebtedness in favor of LLCP, to extend the maturity of their debt until June 2004, and to reduce their interest rate from 15% to 12.5%. Such affiliates received in return the option to convert such debt into an aggregate of 1,666,667 shares of common stock at the rate of \$3.00 per share through maturity at June 30, 2004. Additionally, SFSC also agreed to subordinate \$6.0 million, or 40%, of its RPL in favor of LLCP.

In April 1999, the Company issued an additional \$5.0 million of subordinated promissory notes due April 30, 2004, to the same affiliate of LLCP as noted above, and received proceeds (net of \$312,000 of capitalized issuance costs) of \$4.7 million. The Company also issued warrants to purchase 1,335,000 shares of the Company's common stock at \$0.01 per share to LLCP, exercisable through April 2009. The debt bears interest at 14.5% per annum, and may be prepaid without penalty at anytime. As part of the purchase agreement, the interest rate on the previously issued LLCP notes was increased to 14.5% per annum, and the warrant to purchase 3,450,000 shares of the Company's common stock at \$3.00 per share was exchanged for a warrant to purchase 3,115,000 shares at a price of \$0.01 per share.

In March 2000, the Company issued \$16.0 million of senior secured debt to LLCP. The proceeds from the issuance were used to repay in full all amounts owed under the Senior Secured Line. As part of the agreement, all of LLCP's existing debt of \$30.0 million, was restructured as senior secured debt, making the Company's aggregate principal indebtedness to LLCP equal to \$46.0 million. The \$16.0 million bears interest at 12.5% per annum and the interest rate on the \$30 million is unchanged at 14.5% per annum. As part of the agreement, all prior defaults were either waived or cured. As of December 31, 2000, the amount outstanding of the \$16.0 million portion of senior secured debt was \$8.0 million.

On April 15, 1997, the Company issued \$20.0 million in subordinated participating equity notes ("PENs") due April 15, 2004. The PENs are unsecured general obligations of the Company. Interest on the PENs is payable on the fifteenth of each month, commencing May 15, 1997, at an interest rate of 10.5% per annum. In connection with the

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

issuance of the PENs, the Company incurred and capitalized issuance costs of \$1.2 million. The Company recognizes interest and amortization expense related to the PENs using the effective interest method over the expected redemption period. The PENs are subordinated to certain existing and future indebtedness of the Company as defined in the indenture agreement. The Company may at its option elect to redeem the PENs from the registered holders, in whole but not in part, at any time on or after April 15, 2000, at 100% of their principal amount, subject to limited conversion rights, plus accrued interest to and including the date of redemption. At maturity, upon the exercise by the Company of an optional redemption, or upon the occurrence of a "Special Redemption Event," each holder will have the right to convert into common stock of the Company ("Common Stock"), 25% of the aggregate principal amount of the PENs held by such holder at the conversion price of \$10.15 per share of Common Stock. "Special Redemption Events" are certain events related to a change in control of the Company.

On December 20, 1995, the Company issued \$20.0 million in rising interest subordinated redeemable securities due January 1, 2006 (the "Notes"). The Notes are unsecured general obligations of the Company. Interest on the Notes is payable on the first day of each month, commencing February 1, 1996, at an interest rate of 10.0% per annum. The interest rate increases 0.25% on each January 1 for the first nine years and 0.50% in the last year. In connection with the issuance of the Notes, the Company incurred and capitalized issuance costs of \$1.1 million. The Notes are subordinated to certain existing and future indebtedness of the Company as defined in the indenture agreement. The Company is required to redeem, subject to certain adjustments, \$1.0 million of the aggregate principal amount of the Notes through the operation of a sinking on or before of January 1, 2000, 2001, 2002, 2003, 2004 and 2005. The Company may at its option elect to redeem the Notes from the registered holders of the Notes, in whole or in part at 100% of their principal amount, plus accrued interest to and including the date of redemption. During each of 2000 and 1999, the Company redeemed \$1.0 million of principal amount of the notes in conjunction with the requirements of the related sinking fund agreement. The balance outstanding of the Notes at December 31, 2000 and 1999, was \$17.7 million and \$19.0 million, respectively.

During the year ended December 31, 1997 the Company acquired CPS Leasing, Inc. At December 31, 2000 and 1999, CPS Leasing, Inc., had borrowings to banks of \$2.4 million and \$3.3 million, respectively.

As of December 31, 1999, the Company's subordinated debt exceeded its consolidated net worth, which excess was an event of default under the indentures governing the RISRS and PENs. The event of default was cured on March 16, 2000, by the issuance of senior secured debt in exchange for outstanding subordinated debt.

With respect to all borrowings listed above, the Company was in compliance with all related financial covenants as of December 31, 2000.

The following table summarizes the amount of Senior Secured, subordinated and related party debt maturing over the next 5 years and thereafter:

	<u>Principal Amount</u> (in thousands)
2001 .....	\$ 8,699
2002 .....	1,000
2003 .....	1,000
2004 .....	72,500
2005 .....	—
Thereafter .....	<u>14,000</u>
Total .....	<u>\$ 97,199</u>

**(13) Employee Benefits**

The Company sponsors 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). The Company matches 100% of employees' contributions up to \$600 per employee per calendar year. The Company's

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

contributions to the 401(k) Plan were \$213,045, \$300,791 and \$250,428 for the years ended December 31, 2000, 1999 and 1998, respectively.

**(14) Fair Value of Financial Instruments**

The following summary presents a description of the methodologies and assumptions used to estimate the fair value of the Company's 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 the Company's financial instruments, active markets do not exist. Therefore, considerable judgments 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, 2000 and 1999, the amounts that will actually be realized or paid at settlement or maturity of the instruments could be significantly different. The estimated fair values of financial assets and liabilities at December 31, 2000 and 1999, were as follows:

<u>Financial Instrument</u>	<u>December 31,</u>			
	<u>2000</u>		<u>1999</u>	
	<u>Carrying Value or Notional Amount</u>	<u>Fair Value</u>	<u>Carrying Value or Notional Amount</u>	<u>Fair Value</u>
	(in thousands)			
Cash .....	\$ 19,051	\$ 19,051	\$ 1,290	\$ 1,290
Restricted cash .....	5,264	5,264	2,034	2,034
Contracts held for sale.....	18,830	18,830	2,421	2,421
Contracts held to maturity.....	302	151	1,939	969
Residual interest in securitizations	99,199	99,199	172,530	172,530
Related party receivables .....	899	899	901	901
Commitments .....	2,403	64	1,661	44
Warehouse lines of credit.....	2,003	2,003	—	—
Notes payable.....	2,414	2,414	4,006	4,006
Senior secured debt.....	38,000	38,000	23,161	23,161
Subordinated debt .....	37,699	27,709	69,000	45,678
Related party debt .....	21,500	15,803	21,500	14,233

*Cash and Restricted Cash*

The carrying value equals fair value.

*Contracts held for sale*

The fair value of the Company's contracts held for sale is determined by purchase commitments from investors and prevailing market rates.

*Contracts held to maturity*

The fair value of the Company's contracts held to maturity is determined by purchase commitments from investors and prevailing market rates.

*Residual Interest in Securitizations*

The fair value is estimated by discounting future cash flows using credit and discount rates that the Company believes reflect the estimated credit, interest rate and prepayment risks associated with similar types of instruments.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Related Party Receivables*

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

*Commitments*

The fair value of commitments to purchase contracts from Dealers is determined by purchase commitments from investors and prevailing market rates.

*Warehouse Line of Credit*

The carrying value approximates fair value because the warehouse line of credit is short-term in nature and the related interest rates are estimated to reflect current market conditions for similar types of instruments.

*Notes Payable and Senior Secured*

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

*Subordinated Debt*

The fair value is based on average trading activity occurring in the last 5 days of the respective periods.

*Related Party Debt*

The fair value is based on the fair value of subordinated debt, as the terms and structure are similar.

**(15) Liquidity**

The Company's business requires substantial cash to support its purchases of Contracts and other operating activities. The Company's primary sources of cash from operating activities have been proceeds from sales of Contracts, amounts borrowed under lines of credit, servicing fees on portfolios of Contracts previously sold, customer payments of principal and interest on Contracts held for sale, fees for origination of Contracts, and releases of cash from Spread Accounts. The Company's primary uses of cash have been the purchases of Contracts, repayment of amounts borrowed under lines of credit and otherwise, operating expenses such as employee, interest, and occupancy expenses, the establishment of and further contributions to Spread Accounts, and income taxes. Internally generated cash may or may not be sufficient to meet the Company's cash demands, depending on the performance of securitized pools (which determines the level of releases from Spread Accounts), on the rate of growth or decline in the Company's servicing portfolio, and on the terms on which the Company is able to buy, borrow against and sell Contracts.

Contracts are purchased from Dealers for a cash price close to their principal amount, and return cash over a period of years. As a result, the Company has been dependent on lines of credit to purchase Contracts, and on the availability of cash from outside sources in order to finance its continued operations, and to fund the portion of Contract purchase prices not borrowed under lines of credit. For much of the three-year period ended December 31, 2000, the Company was not party to any line of credit that would facilitate purchase of Contracts. Furthermore, the Company did not receive any material releases of cash from Spread Accounts from June 1998 through October 1999. The inability to borrow and the lack of cash releases resulted in a liquidity deficiency, which has since been alleviated.

The Company's Contract purchasing program currently comprises both (i) purchases for the Company's own account, funded primarily by advances under a revolving credit facility, and (ii) flow purchases for the account of

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

non-affiliates. Flow purchases allow the Company to purchase Contracts with minimal demands on liquidity. The Company's revenues from flow purchase of Contracts, however, are materially less than may be received by holding Contracts to maturity or by selling Contracts in securitization transactions. For the year ended December 31, 2000, the Company purchased \$600.4 million of Contracts on a flow basis, and \$31.1 million for its own account, compared to \$424.7 million of Contracts purchased, \$241.2 million of which was purchased on a flow basis, in the prior year.

Net cash provided by operating activities was \$38.7 million for the year ended December 31, 2000, compared to net cash used in operating activities of \$180,000 for the same period in the prior year. During the years ended December 31, 2000, and 1999, the Company did not complete a securitization transaction, and therefore, did not use any cash for initial deposits to Spread Accounts. Cash used for subsequent deposits to Spread Accounts for the year ended December 31, 2000, was \$15.0 million, a decrease of \$8.1 million, or 34.9%, from cash used for subsequent deposits to Spread Accounts for the prior year. Cash released from Spread Accounts to the Company for the year ended December 31, 2000, was \$80.6 million, as compared with \$28.0 million for the prior year. Changes in deposits to and releases from Spread Accounts are affected by the relative size, seasoning and performance of the various pools of sold Contracts that make up the Company's Servicing Portfolio. In particular, in the prior year most of the cash generated by Contracts held by the Trusts was directed, pursuant to the Securitization Agreements, to building Spread Accounts to their respective specified levels. Those levels having been reached in November 1999, cash subsequently generated has been available for release to the Company.

From June 1998 to November 1999, the Company's liquidity was adversely affected by the absence of releases from Spread Accounts. Such releases did not occur because a number of the Trusts had incurred cumulative net losses as a percentage of the original Contract balance or average delinquency ratios in excess of the predetermined levels specified in the respective Securitization Agreements. Accordingly, pursuant to the Securitization Agreements, the specified levels applicable to the Company's Spread Accounts were increased, in most cases to an unlimited amount. Due to cross collateralization provisions of the Securitization Agreements, the specified levels were increased on all but the two most recent of the Company's Trusts. Increased specified levels for the Spread Accounts have been in effect from time to time in the past. As a result of the increased Spread Account specified levels and cross collateralization provisions, excess cash flows that would otherwise have been released to the Company instead were retained in the Spread Accounts to bring the balance of those Spread Accounts up to higher levels. In addition to requiring higher Spread Account levels, the Securitization Agreements provide the Certificate Insurer with certain other rights and remedies, some of which have been waived on a recurring basis by the Certificate Insurer with respect to all of the Trusts. Until the November 1999 effectiveness of an amendment (the "Amendment") to the Securitization Agreements, no material releases from any of the Spread Accounts were available to the Company. Upon effectiveness of the Amendment, the requisite Spread Account levels in general have been set at 21% of the outstanding principal balance of the Certificates issued by the related Trusts. The 21% level is subject to adjustment to reflect over collateralization. Older Trusts may require more than 21% of credit enhancement if the Certificate balance has amortized to such a level that "floor" or minimum levels of credit enhancement are applicable.

In the event of certain defaults by the Company, the specified level applicable to such credit enhancement could increase to an unlimited amount, but such defaults are narrowly defined, and the Company does not anticipate suffering such defaults. The Amendment has been effective since November 1999, and the Company has received releases of cash from the securitized portfolio on a monthly basis thereafter. The releases of cash are expected to continue and to vary in amount from month to month. There can be no assurance that such releases of cash will continue in the future.

Since November 2000, the Company has been able to purchase Contracts for its own account using proceeds from a \$75 million revolving note purchase facility. Approximately 75% of the acquisition cost of Contracts may be advanced to the Company under that facility. The Company also purchases Contracts on a flow basis, which, as compared with purchase of Contracts for the Company's own account, involves a materially reduced demand on the Company's cash. Cash requirements are reduced because the Company need only fund such purchases for the period of several days that elapse between payment to the Dealer and receipt of funds from the flow purchasers. The Company's plan for meeting its liquidity needs is to adjust its levels of Contract purchases to match its availability of cash.

**CONSUMER PORTFOLIO SERVICES, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Concluded)**

The Company's ability to adjust the quantity of Contracts that it purchases and sells will be subject to general competitive conditions and other factors. There can be no assurance that the current level of Contract acquisition can be maintained or increased. Obtaining releases of cash from the Spread Accounts is dependent on collections from the related Trusts generating sufficient cash in excess of the amended specified levels. There can be no assurance that collections from the related Trusts will generate cash in excess of the amended specified levels.

The acquisition of Contracts for subsequent sale in securitization transactions, and the need to fund Spread Accounts 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 the Company's Contract purchases (other than flow purchases), the required level of initial credit enhancement in securitizations, and the extent to which the Spread Accounts either release cash to the Company or capture cash from collections on sold Contracts. The Company plans to adjust its levels of Contract purchases so as to match anticipated releases of cash from Spread Accounts with capital requirements for securitization of Contracts that are purchased for the Company's own account.

**(16) Subsequent Events**

In January 2001, the Company's board of directors authorized the Company to make early repayments on portions of certain debt. During the first quarter of 2001, the Company repaid \$4.0 million of senior secured debt, and \$4.0 million of related party subordinated debt, incurring \$200,000 in prepayment penalties and waiver fees.

**(17) Selected Quarterly Data (Unaudited)**

	<u>Quarter Ended March 31,</u>	<u>Quarter Ended June 30,</u>	<u>Quarter Ended September 30,</u>	<u>Quarter Ended December 31,</u>
	(in thousands, except per share data)			
2000				
Revenues .....	\$ 374	\$ 13,550	\$ 14,256	\$ 7,771
Loss before income taxes .....	(17,517)	(3,186)	(1,491)	(10,209)
Net loss .....	(11,097)	(3,186)	(1,178)	(6,686)
Loss per share:				
Basic .....	\$ (0.55)	\$ (0.16)	\$ (0.06)	\$ (0.33)
Diluted .....	\$ (0.55)	\$ (0.16)	\$ (0.06)	\$ (0.33)
1999				
Revenues .....	\$ 20,824	\$ 13,406	\$ (9,204)	\$ (10,221)
Loss before income taxes .....	(3,667)	(11,925)	(28,559)	(28,012)
Net income .....	(2,127)	(6,910)	(16,569)	(18,926)
Loss per share:				
Basic .....	\$ (0.14)	\$ (0.37)	\$ (0.82)	\$ (0.94)
Diluted .....	\$ (0.14)	\$ (0.37)	\$ (0.82)	\$ (0.94)
1998				
Revenues .....	\$ 24,782	\$ 29,724	\$ 34,577	\$ 37,197
Loss before income taxes .....	9,658	10,240	10,744	13,678
Net income .....	5,603	5,925	6,238	7,937
Earnings per share:				
Basic .....	\$ 0.37	\$ 0.39	\$ 0.40	\$ 0.51
Diluted .....	\$ 0.34	\$ 0.36	\$ 0.38	\$ 0.44

## EXHIBIT INDEX

<u>Exhibit Number</u>	<u>Description</u>
3.1	Restated Articles of Incorporation(1)
3.2	Amended and Restated Bylaws(2)
4.1	Indenture re Rising Interest Subordinated Redeemable Securities (“RISRS”)(3)
4.2	First Supplemental Indenture re RISRS(3)
4.3	Form of Indenture re 10.50% Participating Equity Notes (“PENs”)(4)
4.4	Form of First Supplemental Indenture re PENs(4)
10.1	1991 Stock Option Plan & forms of Option Agreements thereunder(5)
10.2	1997 Long-Term Incentive Stock Plan(5)
10.3	Lease Agreement re Chesapeake Collection Facility(6)
10.4	Lease of Headquarters Building(7)
10.5	Partially Convertible Subordinated Note(7)
10.6	Registration Rights Agreement(7)
10.7	Residual Interest in Securitizations Revolving Credit and Term Loan Agreement dated as of April 30, 1998, between registrant and State Street Bank and Trust Company(8)
10.7a	Second Amendment Agreement dated November 17, 1998 re: State Street residual interest in Securitizations Revolving Credit and Term Loan Agreement(9)
10.7b	Amendment and Forbearance Agreement(10)
10.8	Pledge and Security Agreement dated as of April 30, 1998, between the Company and State Street Bank and Trust Company(8)
10.9	Revolving Credit and Term Note dated April 30, 1998(8)
10.10	Subscription Agreement regarding shares issued in July 1998(11)
10.11	Registration Rights Agreement regarding shares issued in July 1998(11)
10.12	Amended and Restated Motor Vehicle Installment Contract Loan and Security Agreement(9)
10.13	FSA Warrant Agreement dated November 30, 1998(9)
10.14	Securities Purchase Agreement dated November 17, 1998(12)
10.14a	First Amendment dated as of April 15, 1999, to Securities Purchase Agreement dated as of November 17, 1998, between the Company and Levine Leichtman Capital Partners II, L.P. (“LLCP”). (said Securities Purchase Agreement, as amended, is referred to below as the “Amended SPA”)(13)
10.14b	Amended and Restated Securities Purchase Agreement dated as of March 15, 2000, between the LLC and the Company(14)
10.15	Senior Subordinated Primary Note dated November 17, 1998(12)
10.15a	Senior Subordinated Primary Note in the principal amount of \$25,000,000, as amended and restated pursuant to the Amended SPA(13)
10.16	Primary Warrant to purchase 3,450,000 shares of common stock dated November 17, 1998(12)
10.16a	Primary Warrant to Purchase 3,115,000 Shares of Common Stock, as amended and restated pursuant to the Amended SPA(13)
10.17	Investor Rights Agreement dated November 17, 1998(12)
10.17a	First Amendment to Investors Rights Agreement, dated as of April 15, 1999(13)
10.18	Waiver Agreement dated as of March 15, 2000, between LLC and the Company(14)
10.19	Amended and Restated Investor Rights Agreement dated as of March 15, 2000(14)
10.20	Registration Rights Agreement dated as of November 17, 1998(12)
10.20a	First Amendment to Registration Rights Agreement, dated as of April 15, 1999(13)

<u>Exhibit Number</u>	<u>Description</u>
10.20b	Amended and Restated Registration Rights Agreement dated as of March 15, 2000, between LLC and the Company(14)
10.21	Subordination Agreement dated as of November 17, 1998 re: Stanwich Note and Poole Note(9)
10.22	Investment Agreement and Continuing Guaranty, dated as of April 15, 1999(13)
10.23	Termination and Settlement Agreement with Respect to Investment Agreement and Continuing Guaranty dated as of March 15, 2000(14)
10.24	Consolidated Registration Rights Agreement dated November 17, 1998 re: 1997 Stanwich Notes(9)
10.25	Securities Purchase Agreement dated as of April 15, 1999, between the Company and LLC(13)
10.26	Senior Subordinated Note in the principal amount of \$5,000,000(13)
10.27	Amended and Restated Secured Senior Note Due 2003 in the principal amount of \$30,000,000(14)
10.28	Secured Senior Note Due 2001 in the principal amount of \$16,000,000(14)
10.29	Warrant to Purchase 1,335,000 Shares of Common Stock(13)
10.30	FSA Letter Agreement dated November 17, 1998(9)
10.31	Agreement dated May 29, 1999 for Sale of Contracts on a Flow Basis(15)
10.32	Amendment to Master Spread Account Agreement(16)
10.33	Sale and Servicing Agreement dated November 17, 2000 (to be filed by amendment)
10.34	Indenture dated as of November 17, 2000 (to be filed by amendment)
21.1	Subsidiaries of the Company(9)
23.1	Consent of independent auditors (filed herewith)

Each exhibit marked above with a number enclosed in parentheses is incorporated in this report by reference. The reference is to the report filed by or with respect to Consumer Portfolio Services, Inc. as specified below:

- 
- (1) Form 10-KSB dated December 31, 1995
  - (2) Form 10-K dated December 31, 1997
  - (3) Form 8-K filed December 26, 1995
  - (4) Form S-3, no. 333-21289
  - (5) Form 10-KSB dated March 31, 1994
  - (6) Form 10-K dated December 31, 1996
  - (7) Form 10-Q dated September 30, 1997
  - (8) Form 10-Q dated March 31, 1998
  - (9) Form 10-K dated December 31, 1998
  - (10) Form 10-Q dated September 30, 1999
  - (11) Form 10-Q dated June 30, 1998
  - (12) Schedule 13D filed November 25, 1988
  - (13) Schedule 13D filed on April 21, 1999
  - (14) Schedule 13D filed on March 24, 2000
  - (15) Form 10-Q dated June 30, 1999
  - (16) Form 10-K dated December 31, 1999