

CONSUMER PORTFOLIO SERVICES INC
Form 10-Q
August 08, 2016

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

Commission file number: 1-11416

CONSUMER PORTFOLIO SERVICES, INC.

(Exact name of registrant as specified in its charter)

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

3800 Howard Hughes Parkway, Suite 1400,
Las Vegas, Nevada 89169
(Address of principal executive offices) (Zip Code)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer Accelerated Filer

Non-Accelerated Filer Smaller Reporting Company

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

As of August 2, 2016 the registrant had 23,865,015 common shares outstanding.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

INDEX TO FORM 10-Q

For the Quarterly Period Ended June 30, 2016

	<u>Page</u>
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	
Unaudited Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015	3
Unaudited Condensed Consolidated Statements of Operations for the three-month and six-month periods ended June 30, 2016 and 2015	4
Unaudited Condensed Consolidated Statements of Comprehensive Income for the three-month and six-month periods ended June 30, 2016 and 2015	5
Unaudited Condensed Consolidated Statements of Cash Flows for the six-month periods ended June 30, 2016 and 2015	6
Notes to Unaudited Condensed Consolidated Financial Statements	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	19
Item 4. Controls and Procedures	34
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	35
Item 1A. Risk Factors	35
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	36
Item 6. Exhibits	36
Signatures	37

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

	June 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents	\$15,752	\$19,322
Restricted cash and equivalents	115,268	106,054
Finance receivables	2,218,389	1,985,093
Less: Allowance for finance credit losses	(90,168)	(75,603)
Finance receivables, net	2,128,221	1,909,490
Finance receivables measured at fair value	13	61
Furniture and equipment, net	1,792	1,715
Deferred tax assets, net	40,350	37,597
Accrued interest receivable	33,598	31,547
Other assets	19,915	23,139
	\$2,354,909	\$2,128,925
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable and accrued expenses	\$38,509	\$29,509
Warehouse lines of credit	165,103	194,056
Residual interest financing	7,455	9,042
Securitization trust debt	1,956,620	1,720,021
Subordinated renewable notes	15,257	15,138
	2,182,944	1,967,766
COMMITMENTS AND CONTINGENCIES		
Shareholders' Equity		
Preferred stock, \$1 par value; authorized 4,998,130 shares; none issued	—	—
Series A preferred stock, \$1 par value; authorized 5,000,000 shares; none issued	—	—
Series B preferred stock, \$1 par value; authorized 1,870 shares; none issued	—	—
Common stock, no par value; authorized 75,000,000 shares; 24,088,674 and 25,616,460 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	77,657	81,337

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Retained earnings	100,958	86,472
Accumulated other comprehensive loss	(6,650)	(6,650)
	171,965	161,159
	\$2,354,909	\$2,128,925

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2016	2015	June 30, 2016	2015
Revenues:				
Interest income	\$101,709	\$84,900	\$198,372	\$167,259
Servicing fees	24	62	47	210
Other income	3,200	3,399	7,163	6,881
	104,933	88,361	205,582	174,350
Expenses:				
Employee costs	15,678	13,144	30,822	27,630
General and administrative	6,569	5,108	11,900	9,944
Interest	19,727	13,688	37,548	26,861
Provision for credit losses	44,423	35,683	88,619	69,122
Marketing	4,731	4,436	9,401	8,639
Occupancy	1,288	949	2,371	1,904
Depreciation and amortization	192	153	367	301
	92,608	73,161	181,028	144,401
Income before income tax expense	12,325	15,200	24,554	29,949
Income tax expense	5,053	6,663	10,068	13,079
Net income	\$7,272	\$8,537	\$14,486	\$16,870
Earnings per share:				
Basic	\$0.30	\$0.33	\$0.58	\$0.65
Diluted	0.25	0.27	0.49	0.53
Number of shares used in computing earnings per share:				
Basic	24,538	26,234	24,917	25,936
Diluted	29,111	31,917	29,632	31,955

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$7,272	\$8,537	\$14,486	\$16,870
Other comprehensive income/(loss); change in funded status of pension plan	—	—	—	—
Comprehensive income	\$7,272	\$8,537	\$14,486	\$16,870

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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

	Six Months Ended	
	June 30,	
	2016	2015
Cash flows from operating activities:		
Net income	\$ 14,486	\$ 16,870
Adjustments to reconcile net income to net cash provided by operating activities:		
Accretion of deferred acquisition fees	(2,114)	(5,318)
Amortization of discount on securitization trust debt	20	41
Depreciation and amortization	367	301
Amortization of deferred financing costs	4,129	3,437
Provision for credit losses	88,619	69,122
Stock-based compensation expense	2,595	2,176
Interest income on residual assets	—	(65)
Changes in assets and liabilities:		
Accrued interest receivable	(2,051)	(4,707)
Deferred tax assets, net	(2,753)	630
Other assets	1,032	5,697
Accounts payable and accrued expenses	9,000	707
Net cash provided by operating activities	113,330	88,891
Cash flows from investing activities:		
Purchases of finance receivables held for investment	(631,412)	(503,791)
Payments received on finance receivables held for investment	326,176	264,226
Payments received on receivables portfolio at fair value	48	1,348
Change in repossessions held in inventory	2,192	1,391
Change in restricted cash and cash equivalents, net	(9,214)	(24,740)
Purchase of furniture and equipment	(444)	(832)
Net cash used in investing activities	(312,654)	(262,398)
Cash flows from financing activities:		
Proceeds from issuance of securitization trust debt	662,150	495,000
Proceeds from issuance of subordinated renewable notes	904	431
Payments on subordinated renewable notes	(785)	(682)
Net repayments of warehouse lines of credit	(29,853)	4,932
Repayments of residual interest financing debt	(1,587)	(1,053)
Repayment of securitization trust debt	(424,155)	(317,963)
Repayment of debt secured by receivables measured at fair value	—	(1,250)
Payment of financing costs	(4,645)	(4,968)
Purchase of common stock	(6,323)	(1,773)

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Exercise of options and warrants	48	1,410
Net cash provided by financing activities	195,754	174,084
Increase (decrease) in cash and cash equivalents	(3,570)	577
Cash and cash equivalents at beginning of period	19,322	17,859
Cash and cash equivalents at end of period	\$ 15,752	\$ 18,436
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	\$32,746	\$22,941
Income taxes	\$3,784	\$8,455

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Description of Business

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

Basis of Presentation

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

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

Use of Estimates

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

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

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

	Three Months Ended June 30, 2016		Six Months Ended June 30, 2015	
	2016	2015	2016	2015
	(In thousands)		(In thousands)	
Direct mail revenues	\$2,378	\$2,382	\$5,222	\$4,519
Convenience fee revenue	460	530	1,105	1,480
Recoveries on previously charged-off contracts	122	308	365	500
Sales tax refunds	202	144	401	294
Other	38	35	70	88
Other income for the period	\$3,200	\$3,399	\$7,163	\$6,881

Warrants

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

Stock-based Compensation

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

For the three and six months ended June 30, 2016, we recorded stock-based compensation costs in the amount of \$1.2 million and \$2.6 million, respectively. These stock-based compensation costs were \$1.1 million and \$2.2 million for the three and six months ended June 30, 2015. As of June 30, 2016, unrecognized stock-based compensation costs to be recognized over future periods equaled \$13.2 million. This amount will be recognized as expense over a weighted-average period of 2.5 years.

The following represents stock option activity for the six months ended June 30, 2016:

	Number of Shares (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term
Options outstanding at the beginning of period	11,228	\$ 4.66	5.55 years
Granted	2,015	3.48	N/A
Exercised	(29)	1.18	N/A
Forfeited	–	–	N/A
Options outstanding at the end of period	13,214	\$ 4.49	5.33 years
Options exercisable at the end of period	7,288	\$ 3.82	4.66 years

At June 30, 2016, the aggregate intrinsic value of options outstanding and exercisable was \$10.8 million and \$9.6 million, respectively. There were 29,200 options exercised for the six months ended June 30, 2016 compared to 978,000 for the comparable period in 2015. The total intrinsic value of options exercised was \$91,000 and \$5.4 million for the six-month periods ended June 30, 2016 and 2015. There were 3.5 million shares available for future stock option grants under existing plans as of June 30, 2016.

CONSUMER PORTFOLIO SERVICES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Purchases of Company Stock

During the six-month period ended June 30, 2016, we purchased 1.6 million shares of our stock in the open market at an average price of \$4.06.

During the six-month period ended June 30, 2015, we purchased 361,046 shares of our common stock, at an average price of \$6.39. We purchased 285,473 shares of our stock in the open market at an average price of \$6.21. The remaining purchases of 75,573 shares were related to net exercises of outstanding options and warrants. In transactions during the six-month period ended June 30, 2015, the holders of options and warrants to purchase 392,200 shares of our common stock paid the aggregate \$535,000 exercise price by surrender to us of 75,573 of such 392,200 shares.

New Accounting Pronouncements

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

Reclassifications

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

Financial Covenants

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

Provision for Contingent Liabilities

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

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

(2) *Finance Receivables*

Our portfolio of finance receivables consists of small-balance homogeneous contracts comprising a sing