

ONYX ACCEPTANCE CORP
Form 10-Q
May 15, 2001

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 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 MARCH 31, 2001

OR

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

FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER: 28050

ONYX ACCEPTANCE CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
Incorporation or organization)

33-0577635
(I.R.S. Employer
Identification No.)

Onyx Acceptance Corporation

27051 Towne Centre Drive

Foothill Ranch, CA 92610

(949) 465-3900

(Address and telephone number of principal executive offices)

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

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YES [X] NO []

As of May 14, 2001, there were 4,992,420 shares of registrant's Common Stock, par value \$.01 per share outstanding.

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ONYX ACCEPTANCE CORPORATION

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
[UNAUDITED]

| | MARCH 31, 2001 | DECEMBER 31, 2000 |
|--|------------------------|----------------------|
| | ----- | ----- |
| | (DOLLARS IN THOUSANDS) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 5,941 | \$ 3,130 |
| Credit enhancement assets | 156,550 | 146,013 |
| Contracts held for sale (Net of allowance) | 187,502 | 170,755 |
| Other assets | 11,465 | 11,482 |
| | ----- | ----- |
| Total assets | \$361,458 | \$331,380 |
| | ===== | ===== |
| LIABILITIES | | |
| Accounts payable | \$ 29,713 | \$ 22,706 |
| Debt | 251,087 | 233,152 |
| Other liabilities | 21,705 | 19,929 |
| | ----- | ----- |
| Total liabilities | 302,505 | 275,787 |
| EQUITY | | |
| Common stock | | |
| Par value \$.01 per share; authorized 15,000,000 shares; issued and outstanding 4,989,504 as of March 31, 2001 and 4,989,504 as of December 31, 2000 | 50 | 50 |
| Paid in capital | 32,601 | 32,601 |
| Retained earnings | 22,435 | 21,550 |
| Accumulated other comprehensive income, net of tax | 3,867 | 1,392 |
| | ----- | ----- |
| Total equity | 58,953 | 55,593 |
| | ----- | ----- |
| Total liabilities and equity | \$361,458 | \$331,380 |
| | ===== | ===== |

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | THREE MONTHS ENDED MARCH 31, | |
|--|---------------------------------|-----------|
| | 2001 | 2000 |
| | ----- | ----- |
| (DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) | | |
| (UNAUDITED) | | |
| Revenues: | | |
| Interest income | \$ 5,637 | \$ 8,898 |
| Interest expense -- Warehouse lines | 4,186 | 4,940 |
| | ----- | ----- |
| Net interest income | 1,451 | 3,958 |
| Gain on sale of contracts | 9,319 | 12,757 |
| Service fee income | 14,248 | 8,679 |
| | ----- | ----- |
| Total Revenues | 25,018 | 25,394 |
| Expenses: | | |
| Provision for credit losses | 334 | 434 |
| Interest expense-other | 1,540 | 1,446 |
| Operating Expenses: | | |
| Salaries and benefits | 12,507 | 11,503 |
| Systems and servicing | 1,550 | 1,574 |
| Telephone and data lines | 1,150 | 1,647 |
| Depreciation | 1,254 | 1,002 |
| General and administrative expenses | 5,170 | 4,929 |
| | ----- | ----- |
| Total Operating Expenses | 21,631 | 20,655 |
| | ----- | ----- |
| Total Expenses | 23,505 | 22,535 |
| | ----- | ----- |
| Income before Income Taxes | 1,513 | 2,859 |
| Income Taxes | 628 | 1,186 |
| | ----- | ----- |
| Net Income | \$ 885 | \$ 1,673 |
| | ===== | ===== |
| Net Income per share - Basic | \$ 0.18 | \$ 0.27 |
| Net Income per share - Diluted | \$ 0.17 | \$ 0.26 |
| Basic Shares Outstanding | 4,989,504 | 6,179,922 |
| Diluted Shares Outstanding | 5,132,111 | 6,349,518 |

See the accompanying notes to the condensed consolidated financial statements.

ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (In Thousands)

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[UNAUDITED]

| | SHARES ----- | COMMON STOCK ----- | ADDITIONAL PAID-IN CAPITAL ----- | RETAINED EARNINGS ----- |
|---|-----------------|--------------------------|---|-------------------------------|
| BALANCE, DECEMBER 31, 2000 | 4,990 | \$ 50 | \$ 32,601 | \$ 21,550 |
| Comprehensive income: | | | | |
| Unrealized gains in securitized assets, net of tax of \$1.9 million | | | | |
| Adoption of FAS 133, net of tax of \$596 thousand | | | | |
| Loss on derivatives reclassified to earnings net of tax of \$596 thousand | | | | |
| Unrealized loss in hedging activities, net of tax of \$240 thousand | | | | |
| Net income | | | | 885 |
| Total comprehensive income | | | | 885 |
| BALANCE, MARCH 31, 2001 | 4,990 ===== | \$ 50 ===== | \$ 32,601 ===== | \$ 22,435 ===== |

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | THREE MONTHS ENDED MARCH 31, ----- | |
|---|---------------------------------------|-----------|
| | 2001 | 2000 |
| | ----- | ----- |
| | (DOLLARS IN THOUSANDS) (UNAUDITED) | |
| OPERATING ACTIVITIES: | | |
| Net cash provided by (used in) operating activities | \$ (14,001) | \$ 24,718 |
| INVESTING ACTIVITIES: | | |
| Purchases of property and equipment | (1,032) | (1,147) |
| FINANCING ACTIVITIES: | | |
| Proceeds from exercise of employee options | -- | 6 |
| Payments on capital lease obligations | (91) | (72) |

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| | | |
|---|-----------|-----------|
| Payments on residual lines of credit | (6,817) | (46,054) |
| Proceeds from drawdown on residual | | |
| Lines of credit | 8,750 | 6,000 |
| Paydown of warehouse lines related to | | |
| Securitizations | (331,000) | (407,000) |
| Proceeds from warehouse lines | 347,794 | 425,574 |
| Principal payments on subordinated debt | (792) | (237) |
| Payments on other loans | -- | (116) |
| | ----- | ----- |
| Net cash (used in) provided by financing activities | 17,844 | (21,899) |
| | ----- | ----- |
| | | |
| Increase in cash and cash equivalents | 2,811 | 1,672 |
| Cash and cash equivalents at beginning of period | 3,130 | 5,190 |
| | ----- | ----- |
| Cash and cash equivalents at end of period | \$ 5,941 | \$ 6,862 |
| | ===== | ===== |

See the accompanying notes to the condensed consolidated financial statements.

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ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1

BASIS OF PRESENTATION

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

USE OF ESTIMATES

In conformity with generally accepted accounting principles, management utilizes assumptions and estimates that affect the reported values of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses for each reporting period. The more significant estimates made in the preparation of the Company's condensed consolidated financial statements relate to the credit

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enhancement assets and the gain on sale of motor vehicle retail installment sales and loan contracts ("Contracts"). Such assumptions include, but are not limited to, estimates of loan prepayments, defaults, recovery rates and present value discount rates. The Company uses a combination of its own historical experience and expectation of future performance to determine such estimates. Actual results may differ from the Company's estimates due to numerous factors both within and beyond the control of Company management. Changes in these factors could require the Company to revise its assumptions concerning the amount of voluntary prepayments, the frequency and/or severity of defaults and the recovery rates associated with the disposition of repossessed vehicles.

RECLASSIFICATION

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

NOTE 2 - CONTRACTS HELD FOR SALE

Contracts held for sale consisted of the following:

| | MARCH 31, 2001 | DECEMBER 31, 2000 |
|-------------------------------|-------------------|----------------------|
| | ----- | ----- |
| | (IN THOUSANDS) | |
| Gross contracts held for sale | \$ 193,192 | \$ 177,086 |
| Less unearned interest | (1,819) | (3,302) |
| | ----- | ----- |
| Contracts held for sale | 191,373 | 173,784 |
| Allowance for credit losses | (1,261) | (1,175) |
| Dealer participation | (2,610) | (1,854) |
| | ----- | ----- |
| Total | \$ 187,502 | \$ 170,755 |
| | ===== | ===== |

NOTE 3 -- CREDIT ENHANCEMENT ASSETS

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Credit enhancement assets consisted of the following:

| | MARCH 31, 2001 | DECEMBER 31, 2000 |
|------------------|-------------------|----------------------|
| | ----- | ----- |
| | (IN THOUSANDS) | |
| Trust receivable | \$ 8,075 | \$ 7,510 |
| RISA | 148,475 | 138,503 |
| | ----- | ----- |
| Total | \$156,550 | \$146,013 |
| | ===== | ===== |

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

Prepayment and credit loss assumptions are utilized to project future earnings and are based on historical experience. Credit losses are estimated using cumulative loss frequency and severity estimates by management. All assumptions are evaluated each quarter and adjusted, if appropriate, to reflect the actual performance of the underlying Contracts.

Future earnings are discounted at a rate management believes to be representative of market at the time of securitization. The balance of RISA is amortized against actual excess spread income earned on a monthly basis over the expected repayment life of the underlying Contracts. RISA is classified in a manner similar to available for sale securities and as such is marked to market each quarter. Market value changes are calculated by discounting the remaining projected excess spread using a current market discount rate. Any changes in the market value of the RISA are reported as a separate component of stockholders' equity as an unrealized gain or loss, net of deferred taxes. As of March 31, 2001 the market value of RISA was approximately \$7.1 million higher than cost. As of December 31, 2000 the market value of RISA was approximately \$2.4 million higher than cost.

The following table presents the balances and activity for RISA:

| | MARCH 31, 2001 ----- | DECEMBER 31, 2000 ----- |
|---|------------------------------|-------------------------------|
| | (IN THOUSANDS) | |
| Beginning Balance | \$ 138,503 | \$ 137,171 |
| Additions | 19,757 | 109,173 |
| Amortization | (14,552) | (61,229) |
| Sale of RISA | | (49,924) |
| Change in unrealized gain on securities available for sale | 4,767 | 3,312 |
| Ending Balance | ----- \$ 148,475 ===== | ----- \$ 138,503 ===== |

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

The following table presents the estimated future undiscounted retained interest earnings to be received from securitizations. Estimated future undiscounted RISA earnings are calculated by taking the difference between the coupon rate of the Contracts sold and the weighted average security rate paid to the investors, less the contractually specified servicing fee of 1.0% and

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financial insurance fees, after giving effect to estimated prepayments and assuming no losses. To arrive at the RISA, this amount is reduced by the off balance sheet allowance established for potential future losses and by discounting to present value at the current market discount rates.

| | MARCH 31, 2001 | DECEMBER 31, 2000 |
|--|-------------------|----------------------|
| | ----- | ----- |
| | (IN THOUSANDS) | |
| Estimated net undiscounted RISA earnings | \$ 298,323 | \$ 286,125 |
| Off balance sheet allowance for losses | (117,828) | (116,086) |
| Discount to present value | (32,020) | (31,536) |
| | ----- | ----- |

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| | | |
|---|--------------|--------------|
| Retained interest in securitized assets | \$ 148,475 | \$ 138,503 |
| | ===== | ===== |
| Outstanding balance of contracts sold through Securitizations | \$ 2,590,198 | \$ 2,513,407 |

NOTE 4 - NET INCOME PER SHARE

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

| | THREE MONTHS ENDED MARCH 31, | |
|---|--|---------|
| | 2001 | 2000 |
| | ----- | ----- |
| | (IN THOUSANDS, EXCEPT \$ PER SHARE) | |
| Net Income | \$ 885 | \$1,673 |
| | ===== | ===== |
| Weighted average shares outstanding | 4,990 | 6,180 |
| Net effect of dilutive stock options/warrants | 142 | 170 |
| | ----- | ----- |
| Diluted weighted average shares outstanding | 5,132 | 6,350 |
| | ===== | ===== |
| Net income per share: | | |
| Basic EPS | \$ 0.18 | \$ 0.27 |
| | ===== | ===== |
| Diluted EPS | \$ 0.17 | \$ 0.26 |
| | ===== | ===== |

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At March 31, 2001, there were 1.6 million options and 286.6 thousand warrants outstanding.

NOTE 5 - NEW PRONOUNCEMENTS

In July 2000, the Emerging Issues Task Force reached consensus on Issue No. 99-20 "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The Task Force reached a consensus that the holder should recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date (the "transaction date") over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the holder of the beneficial interest is the transferor, the initial investment would be the allocated carrying amount after application of the relative fair value allocation method required by Statement 140. The amount of accretable yield should not be displayed in the balance sheet. The Task Force further reached a consensus that the holder of a beneficial interest should continue to update the estimate of cash flows over the life of the beneficial interest. The consensus in this issue should be applied to the accounting for interest income and impairment of beneficial interests in securitization transactions meeting the scope criteria of this issue effective for all fiscal quarters beginning after March 15, 2001. The Company is presently assessing the effect of Issue No. 99-20 on the consolidated financial statements of the Company.

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities -- A Replacement of FAS 125." This Statement replaces FAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of FAS 125's provisions without reconsideration. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. The Company has adopted the provisions for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral.

NOTE 6 - CHANGE IN ACCOUNTING PRINCIPLE

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

Adopting the provisions of SFAS No. 133 on January 1, 2001 resulted in a one-time cumulative after-tax reduction in Accumulated Other Comprehensive

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Income as of January 1, 2001, of \$840,000, representing the fair value of the derivatives net of tax.

All components of each derivative's gain or loss were included in the assessment of hedge effectiveness. The Company has reclassified to earnings \$840,000 of its loss from adoption, which was recorded in Accumulated Other Comprehensive Income when the forecasted transaction occurred during the three months ended March 31, 2001.

Cash Flow Hedges

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

The Company uses forward interest rate swaps to hedge the consideration of the forecasted securitizations. The Company's interest rate swap agreements involve arrangements to pay a fixed interest rate and receive a floating interest rate, at specified intervals, calculated on an agreed-upon amortizing notional amounts. The debt and amounts that the Company hedges are determined based on prevailing market conditions and the current shape of the yield curve. Interest rate swap agreements are executed as an integral part of specific securitization transactions.

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

Accounting for Derivatives and Hedging Activities

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

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

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Company discontinues hedge accounting prospectively, as discussed below.

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

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in Accumulated Other Comprehensive Income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in Accumulated Other Comprehensive Income will be recognized immediately in earnings. In a situation in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings.

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NOTE 7 - CONTINGENCIES

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

NOTE 8 - SUBSEQUENT EVENTS

During the second quarter of 2001, the Company priced a securitization totaling \$400.0 million.

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

OVERVIEW

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

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

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securitized Contracts.

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

RESULTS OF OPERATIONS

NET INTEREST INCOME

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

Net interest income totaled approximately \$1.5 million for the three-month period ended March 31, 2001 compared to \$4.0 million for the same period in 2000. The reduction in net interest income was primarily due to the prefunded structure of the securitization executed during the first quarter 2001. A prefunded securitization reduces the time period that the Contracts are held for sale, and as a result, reduces the interest income earned on the related Contracts. However, the Company continues to incur interest expense on warehouse borrowings throughout the prefunded period, until the final prefunded contracts are purchased and delivered to the trust.

GAIN ON SALE OF CONTRACTS

The Company recorded a gain on sale of Contracts of \$9.3 million, or 2.3% of securitized Contracts for the three months ended March 31, 2001, compared to \$12.8 million or 3.0% of securitized Contracts for the same period in 2000. The reduction of the gain was principally due to management's decision to target higher credit-worthy borrowers. In targeting higher credit-worthy borrowers, the Company's weighted average net interest rate spread before issuance costs and losses on securitized Contracts declined to 4.77% versus 5.02% for the same period in 2000. The net interest rate spread is the difference between the weighted average Contract rate of the securitized assets, and the weighted average investor rate inclusive of all costs related to the sale.

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The net interest rate spread is also affected by product mix, general market conditions and overall market interest rates.

SERVICE FEE INCOME

Service fee income includes retained interest income, contractual servicing income and other fee income. Retained interest income represents excess spread earned on securitized Contracts less any losses not absorbed by the off balance sheet allowance for losses. Retained interest income is dependent upon the average excess spread on the securitized Contracts and the size of the serviced portfolio. Changes in the amount of prepayments and credit losses may also affect the amount and timing of retained interest income. Contractual service fee income is earned at a rate of 1% per annum on the outstanding balance of Contracts securitized. Other fee income consists primarily of documentation fees, late charges and deferment fees and is dependent on the number of Contracts originated and the size of the serviced portfolio. Increased competition may also affect the amount of other fee income that the Company may earn when originating or servicing Contracts.

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Service fee income increased to \$14.2 million or 57.0% of total revenues for the three months ended March 31, 2001, compared to \$8.7 million or 34.2% of total revenues for the three months ended March 31, 2000. This increase is due primarily to higher amounts of net excess cash flows generated from the sold portion of the portfolio and service fees as a result of the growth of the serviced portfolio.

PROVISION FOR CREDIT LOSSES

The Company maintains an allowance for credit losses to cover anticipated losses for Contracts held for sale. The allowance for credit losses is increased by adjusting the provision for credit losses to cover additional Contracts originated and increases in loss estimates and decreased by actual losses on the Contracts held for sale or by the reduction of the amount of Contracts held for sale. The level of the allowance is based principally on the outstanding balance of Contracts held for sale and the historical loss trends for the period of time the Contracts are held before being sold in a securitization. When the Company sells Contracts in a securitization transaction, it reduces its allowance for credit losses and factors potential losses into its calculation of gain on sale. The Company believes that the allowance for credit losses is currently adequate to absorb potential losses. The provision for credit losses totaled \$334 thousand for the three months ended March 31, 2001, compared to \$434 thousand for the same period in 2000. Provision for credit losses consists of net credit losses incurred during the warehousing period plus future provision for losses reserved against the net changes in Contracts held for sale during the period. Net credit losses accounted for \$222 thousand during the three months ended March 31, 2001, compared to \$296 thousand for the same period in 2000.

OPERATING EXPENSES

Total operating expenses were \$21.6 million or 3.1% of the average serviced portfolio for the three months ended March 31, 2001 compared to \$20.7 million or 3.7% of the average serviced portfolio for the same period in 2000. The dollar increase in total operating expenses is primarily attributable to an increase in the average serviced portfolio for the period. The average serviced portfolio increased to \$2.8 billion for the three months ended March 31, 2001 from \$2.2 billion for the same period in 2000, an increase of approximately 27%.

The Company incurred salary and benefit expenses of \$12.5 million for the three months ended March 31, 2001, compared to \$11.5 for the same period in 2000. This increase is attributable to the incremental staffing requirements related to the expansion of operations and the growth of the serviced portfolio. The number of employees at the Company, including temporary staff, increased from 920 at March 31, 2000, to 1,152 at March 31, 2001.

System and servicing expenses remained stable at \$1.6 million for the quarters ended March 31, 2000 and 2001, as the Company renegotiated several contracts with its major service providers. The Company has also acquired a loan accounting and collection system during 2000, and intends to bring these processes in-house during 2001.

Telephone and data line charges declined to \$1.2 million from \$1.6 million for the first quarter of 2001 and 2000 respectively. Although these charges generally increase with the growth of the serviced portfolio, the reduction between 2001 and 2000 was primarily due to renegotiated contracts for long distance rates with certain carriers. Assuming no additional reduction in long distance rates, the Company expects these charges to increase with the continued growth of the serviced portfolio.

Depreciation expenses increased to \$1.3 million for the three months ended March 31, 2001 compared to \$1.0 million for the same period in 2000, as the Company continued to invest in technology and infrastructure. General and administrative expenses increased to \$5.2 million for the three months ended March 31, 2001 compared to \$4.9 million for the same period in 2000. Higher expenses are primarily due to the growth of the average serviced portfolio.

INCOME TAXES

The Company files federal and state tax returns. The effective tax rates for March 31, 2001 and 2000 were 41.5%.

FINANCIAL CONDITION

CONTRACTS HELD FOR SALE

Contracts held for sale totaled \$191.4 million at March 31, 2001, compared to \$173.8 million at December 31, 2000. The balance in the held for sale portfolio is largely dependent upon the timing of the origination and securitization of Contracts. The Company completed securitization transactions of \$400.0 million during the first quarter of 2001 and the fourth quarter of 2000. The Company plans to continue to securitize Contracts on a regular basis.

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

SELECTED QUARTERLY FINANCIAL INFORMATION

| | FOR THE QUARTERS ENDED | | |
|--|------------------------|------------------|-------------------|
| | MAR. 31, 2000 | JUNE 30, 2000 | SEPT. 30, 2000 |
| | (DOLLARS IN THOUSANDS) | | |
| Contracts purchased/originated during Period | \$ 468,742 | \$ 434,144 | \$ 367,636 |
| Average monthly volume during period | 156,247 | 144,714 | 122,545 |
| Gain on sale of Contracts | 12,756 | 13,989 | 12,066 |
| Contracts securitized during period | 430,000 | 450,000 | 440,000 |
| Servicing portfolio at period end | 2,344,399 | 2,500,207 | 2,584,152 |

ASSET QUALITY

The Company monitors and attempts to minimize delinquencies and losses through timely collections and the use of a predictive dialing system. At March 31, 2001, delinquencies represented 2.29% of the amount of Contracts in its serviced portfolio compared to 4.14% at December 31, 2000. Net charge-offs as a percentage of the average servicing portfolio were 2.68% for the quarter ended March 31, 2001, compared to 2.33% for the same period in 2000.

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

DELINQUENCY EXPERIENCE OF SERVICING PORTFOLIO

| | MARCH 31, 2001 | | |
|---|----------------|---------|------------------------|
| | AMOUNT | NO. | |
| | | | (DOLLARS IN THOUSANDS) |
| Servicing portfolio | \$2,784,411 | 279,513 | \$2 |
| Delinquencies (1) (2) | | | |
| 31-59 days | \$ 38,021 | 4,116 | \$ |
| 60-89 days | 13,167 | 1,415 | |
| 90+ days | 12,579 | 1,405 | |
| Total | \$ 63,767 | 6,936 | \$ |
| Total delinquencies as a percent of Servicing portfolio | 2.29% | 2.48% | |

(1) Delinquencies include principal amounts only, net of repossessed inventory and accounts in bankruptcy. Delinquent repossessed inventory as a percent of the serviced portfolio was 0.91% and 0.83% at March 31, 2001 and December 31, 2000, respectively. Delinquent contracts in bankruptcy as a percent of the serviced portfolio was 0.60% and 0.52% at March 31, 2001 and December 31, 2000, respectively.

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

LOAN LOSS EXPERIENCE OF SERVICING PORTFOLIO

| | FOR THE THREE MONTHS ENDED MARCH 31, | |
|---|---|------------------------|
| | 2001 | 2000 |
| | | |
| | | (DOLLARS IN THOUSANDS) |
| Average servicing portfolio (1) | \$2,758,385 | \$2,238,058 |
| Number of gross charge-offs | 3,108 | 2,361 |
| Gross charge-offs | \$ 20,907 | \$ 15,054 |
| Net charge-offs (2) | \$ 18,488 | \$ 13,052 |
| Annualized net charge-offs as a percent of average Servicing portfolio | 2.68% | 2.33% |

(1) Average is based on daily balances.

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

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THE FOLLOWING TABLE ILLUSTRATES THE MONTHLY PERFORMANCE OF EACH OF THE SECURITIZED POOLS OUTSTANDING FOR THE PERIOD FROM THE DATE OF SECURITIZATION THROUGH MARCH 31, 2001:

| MONTH | 97-2 | 97-3 | 97-4 | 98-1 | 98-A | 98-B | 98-C | 99-A | 99-B | 99-C | 99-D | 00- |
|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| 1 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| 2 | 0.00% | 0.00% | 0.00% | 0.01% | 0.01% | 0.00% | 0.02% | 0.00% | 0.00% | 0.01% | 0.00% | 0.00% |
| 3 | 0.02% | 0.02% | 0.01% | 0.02% | 0.03% | 0.02% | 0.02% | 0.02% | 0.03% | 0.03% | 0.01% | 0.00% |
| 4 | 0.07% | 0.09% | 0.04% | 0.08% | 0.07% | 0.08% | 0.04% | 0.05% | 0.07% | 0.06% | 0.04% | 0.00% |
| 5 | 0.22% | 0.13% | 0.11% | 0.14% | 0.14% | 0.19% | 0.15% | 0.11% | 0.14% | 0.16% | 0.09% | 0.10% |
| 6 | 0.32% | 0.24% | 0.20% | 0.24% | 0.23% | 0.33% | 0.27% | 0.21% | 0.27% | 0.28% | 0.15% | 0.10% |
| 7 | 0.59% | 0.36% | 0.28% | 0.40% | 0.37% | 0.45% | 0.46% | 0.35% | 0.43% | 0.47% | 0.24% | 0.30% |
| 8 | 0.80% | 0.47% | 0.43% | 0.53% | 0.42% | 0.61% | 0.57% | 0.49% | 0.60% | 0.64% | 0.43% | 0.60% |
| 9 | 0.91% | 0.62% | 0.55% | 0.68% | 0.51% | 0.82% | 0.74% | 0.63% | 0.85% | 0.83% | 0.59% | 0.80% |
| 10 | 1.07% | 0.73% | 0.72% | 0.85% | 0.70% | 0.95% | 0.94% | 0.81% | 1.07% | 1.09% | 0.76% | 1.00% |
| 11 | 1.26% | 0.81% | 0.87% | 1.04% | 0.85% | 1.10% | 1.12% | 1.04% | 1.34% | 1.31% | 0.99% | 1.20% |
| 12 | 1.42% | 0.94% | 0.95% | 1.20% | 1.01% | 1.20% | 1.30% | 1.29% | 1.56% | 1.47% | 1.20% | 1.50% |
| 13 | 1.58% | 1.10% | 1.08% | 1.33% | 1.17% | 1.36% | 1.54% | 1.49% | 1.79% | 1.62% | 1.41% | 1.80% |
| 14 | 1.68% | 1.23% | 1.19% | 1.46% | 1.37% | 1.48% | 1.73% | 1.72% | 1.90% | 1.77% | 1.52% | 2.00% |
| 15 | 1.80% | 1.38% | 1.36% | 1.61% | 1.48% | 1.64% | 1.90% | 1.90% | 2.08% | 2.00% | 1.70% | |
| 16 | 1.97% | 1.58% | 1.42% | 1.71% | 1.59% | 1.89% | 2.10% | 2.10% | 2.23% | 2.08% | 2.00% | |
| 17 | 2.10% | 1.68% | 1.52% | 1.88% | 1.76% | 2.05% | 2.28% | 2.26% | 2.42% | 2.29% | 2.17% | |
| 18 | 2.23% | 1.77% | 1.64% | 2.01% | 1.96% | 2.22% | 2.51% | 2.46% | 2.63% | 2.48% | 2.40% | |
| 19 | 2.35% | 1.91% | 1.75% | 2.17% | 2.07% | 2.37% | 2.71% | 2.59% | 2.71% | 2.61% | | |
| 20 | 2.48% | 2.04% | 1.85% | 2.25% | 2.25% | 2.50% | 2.83% | 2.71% | 2.89% | 2.73% | | |
| 21 | 2.59% | 2.11% | 1.97% | 2.41% | 2.37% | 2.67% | 2.95% | 2.83% | 3.08% | | | |
| 22 | 2.72% | 2.20% | 2.08% | 2.52% | 2.48% | 2.79% | 3.08% | 2.88% | 3.21% | | | |
| 23 | 2.81% | 2.31% | 2.12% | 2.63% | 2.65% | 2.92% | 3.25% | 3.03% | 3.31% | | | |
| 24 | 2.85% | 2.41% | 2.23% | 2.75% | 2.76% | 3.06% | 3.39% | 3.21% | | | | |
| 25 | 2.93% | 2.51% | 2.36% | 2.86% | 2.81% | 3.14% | 3.45% | 3.28% | | | | |
| 26 | 2.96% | 2.59% | 2.41% | 2.98% | 2.95% | 3.23% | 3.57% | 3.34% | | | | |
| 27 | 3.09% | 2.71% | 2.52% | 3.06% | 2.99% | 3.28% | 3.72% | | | | | |
| 28 | 3.17% | 2.79% | 2.55% | 3.15% | 3.03% | 3.35% | 3.81% | | | | | |
| 29 | 3.22% | 2.92% | 2.62% | 3.19% | 3.12% | 3.45% | 3.91% | | | | | |
| 30 | 3.26% | 2.94% | 2.71% | 3.26% | 3.13% | 3.50% | | | | | | |
| 31 | 3.33% | 3.01% | 2.77% | 3.33% | 3.18% | 3.57% | | | | | | |
| 32 | 3.39% | 3.04% | 2.81% | 3.40% | 3.24% | | | | | | | |
| 33 | 3.48% | 3.08% | 2.85% | 3.42% | 3.26% | | | | | | | |
| 34 | 3.51% | 3.11% | 2.88% | 3.46% | 3.28% | | | | | | | |
| 35 | 3.54% | 3.20% | 2.93% | 3.53% | | | | | | | | |
| 36 | 3.55% | 3.21% | 2.91% | 3.56% | | | | | | | | |
| 37 | 3.56% | 3.23% | 2.94% | 3.59% | | | | | | | | |
| 38 | 3.56% | 3.24% | 2.98% | | | | | | | | | |
| 39 | 3.58% | 3.25% | 3.00% | | | | | | | | | |
| 40 | 3.58% | 3.27% | 3.01% | | | | | | | | | |
| 41 | 3.58% | 3.32% | | | | | | | | | | |
| 42 | 3.59% | 3.34% | | | | | | | | | | |
| 43 | 3.60% | 3.36% | | | | | | | | | | |
| 44 | 3.61% | | | | | | | | | | | |
| 45 | 3.61% | | | | | | | | | | | |

LIQUIDITY AND CAPITAL RESOURCES

The Company requires substantial cash and capital resources to operate its business. Its primary uses of cash include: (i) acquisition of Contracts; (ii) payments of dealer participation; (iii) securitization costs; (iv) settlements of hedging transactions; (v) operating expenses; and (vi) interest expense. The capital resources available to the Company include: (i) interest income during the warehousing period; (ii) servicing fees; (iii) releases from spread accounts; (iv) settlements of hedging transactions; (v) sales of Contracts in securitizations; and (vi) borrowings under its credit facilities. Management believes that the resources available to the Company provide the needed capital to fund the anticipated expansion of the Company, Contract purchases, and investments in origination and servicing capabilities.

Cash used in operating activities was \$14.0 million for the three months ended March 31, 2001, compared to \$24.7 million provided in the three months ended March 31, 2000. Cash provided by operating activities during the first quarter of 2000 was primarily due to the securitization of the Company's residual cash flows from 15 of its then outstanding securitizations, resulting in a cash inflow of approximately \$49.0 million. A portion of the proceeds of this transaction was used to pay down two of the Company's residual financing facilities, and to pay off a third residual financing facility. Cash used in investing activities was \$1.0 million for the three months ended March 31, 2001, compared to \$1.1 million for the three months ended March 31, 2000, as the Company continued to invest in technology and infrastructure. Cash provided by financing activities was \$17.8 million for the three months ended March 31, 2001, compared to \$22.0 million used during the three months ended March 31, 2000. The difference was primarily due to the Company reducing its residual lines of credit in connection during March 2000 in connection with the residual securitization.

CP Facilities: As of March 31, 2001, the Company was party to two primary Contract warehousing programs (the "CP Facilities"), one a \$355 million facility with Triple-A One Funding Corporation ("Triple-A"), and the other a \$150 million facility with Park Avenue Receivables Corporation ("Parco"). Two of the Company's special purpose subsidiaries, Onyx Acceptance Financial Corporation ("Finco") for the Triple-A Facility and Onyx Acceptance Receivables Corporation ("Recco") for the Parco Facility, are the borrowers under the CP Facilities. The CP Facilities are used to fund the purchase or origination of Contracts. Triple-A and Parco are both rated commercial paper asset-backed conduits sponsored by MBIA Insurance Corporation ("MBIA") and The Chase Manhattan Bank ("Chase"), respectively. MBIA provides credit enhancement for both facilities by issuing financial guarantee insurance policies covering all principal and interest obligations owed for the borrowings under the facilities. The Company pledges its Contracts held for sale to borrow from Triple-A and from Parco. The Parco Facility was renewed in August 2000, and expires in August 2001, but may be renewed at the option of the lender. The Triple-A Facility was renewed in September 2000. This facility will expire in September 2001 but may be renewed at the option of the lender.

The Residual Lines: The Company, through Fundco, has three residual financing facilities: a \$20.0 million facility with Merrill Lynch International ("MLI") executed in May 2000, a \$50.0 million line with Salomon Smith Barney Realty Corporation ("SBRC") and a \$35.0 million facility with Credit Suisse

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First Boston (Europe) Limited, as buyer ("CSFB-Europe"), and Credit Suisse First Boston Corporation, as agent ("CSFB") executed in October 2000. (The SBRC facility together with the facility with MLI, and the newest facility with CSFB-Europe described above are sometimes referred to herein as the "Residual Lines"). The Residual Lines are used by the Company to finance operating requirements. The lines utilize collateral-based formulas that set borrowing availability to a percentage of the value of excess cash flow to be received from certain securitizations. The facility provided by MLI has a one year term expiring in May 2001, and will not be renewed. Each loan under the SBRC line or the CSFB-Europe line matures one year after the date of the loan; the Company expects each loan to be renewed at term.

Subordinated Debt: As of March 31, 2001, the Company had outstanding approximately \$18.7 million of subordinated debt. \$6.7 million of this amount is being amortized through February 2003 with a stated interest rate of 9.5%. The remaining balance has a stated interest rate of 12.5% and a maturity of June 2006.

The facilities and lines above contain affirmative, negative and financial covenants typical of such credit facilities. The Company was in compliance with these covenants as of March 31, 2001.

Hedging and Interest Rate Risk Management. The Company employs a hedging strategy that is intended to minimize the risk of interest rate fluctuations and which historically has involved the execution of forward interest rate swaps or use of a pre-funding structure for the Company's securitizations. The Company is not required to maintain collateral on the outstanding hedging program.

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SECURITIZATIONS

Regular securitizations are an integral part of the Company's business plan because they allow the Company to increase its liquidity, provide for redeployment of its capital and reduce risks associated with interest rate fluctuations. The Company has developed a securitization program that involves selling interests in pools of its Contracts to investors through the public issuance of AAA/Aaa rated asset-backed securities. The Company completed a AAA/Aaa rated publicly underwritten asset-backed securitization in the amount of \$400 million in the first quarter of 2001.

During the second quarter of 2001, the Company priced a securitization totaling \$400 million.

The net proceeds of securitizations are used to pay down outstanding indebtedness incurred under the Company's credit facilities to purchase Contracts, thereby creating availability for the purchase of additional Contracts. Through March 31, 2001, the Company has securitized \$5.6 billion of its Contracts in 23 separate transactions. In each of its securitizations, the Company has sold its Contracts to a newly formed grantor or owner trust, which issues certificates and/or notes in an amount equal to the aggregate principal balance of the Contracts.

The Company arranges for credit enhancement to achieve an improved credit rating on the asset-backed securities issued. This credit enhancement has taken the form of a financial guaranty insurance policy issued by MBIA or a predecessor of MBIA (the "Financial Guarantee Insurance Policy"), insuring the payment of principal and interest due on the asset-backed securities.

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The Company receives servicing fees for its duties relating to the accounting for and collection of the Contracts. In addition, the Company is entitled to the future excess cash flows arising from the trusts. Generally, the Company sells the Contracts at face value and without recourse, except that certain representations and warranties with respect to the Contracts are provided by the Company as the servicer and Finco as the seller to the trusts.

Gains on sale of Contracts arising from securitizations provide a significant portion of the Company's revenues. Several factors affect the Company's ability to complete securitizations of its Contracts, including conditions in the securities markets generally, conditions in the asset-backed securities market specifically, the credit quality of the Company's portfolio of Contracts and the Company's ability to obtain credit enhancement.

INTEREST RATE EXPOSURE AND HEDGING

The Company is able through the use of varying maturities on advances from the CP Facilities to lock in rates during the warehousing period, when in management's judgment it is appropriate, to limit interest rate exposure during such warehousing period (See "Risk Factors -- Interest Rate Risk").

The Company has the ability to move rates upward in response to rising borrowing costs because the Company currently does not originate Contracts near the maximum rates permitted by law. Further, the Company employs a hedging strategy, which primarily consists of the execution of forward interest rate swaps. These hedges are entered into by the Company in numbers and amounts, which generally correspond to the anticipated principal amount of the related securitization. Gains and losses relative to these hedges are recognized in full at the time of securitization as an adjustment to the gain on sale of the Contracts. The Company has only used counterparties with investment grade debt ratings from national rating agencies for its hedging transactions.

Management monitors the Company's hedging activities on a frequent basis to ensure that the hedges, their correlation to the total consideration to be received in the forecasted securitization and the amounts being hedged continue to provide effective protection against interest rate risk. The Company's hedging strategy requires estimates by management of monthly Contract acquisition volume and timing of its securitizations. If such estimates are materially inaccurate, then the Company's gain on sales of Contracts and results of operations and cash flows could be adversely affected. The amount and timing of hedging transactions are determined by senior management based upon the amount of Contracts purchased and the interest rate environment.

NEW ACCOUNTING PRONOUNCEMENTS

In July 2000, the Emerging Issues Task Force reached consensus on Issue No. 99-20 "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The Task Force reached a consensus that the holder should recognize the excess of all cash flows attributable to the beneficial interest estimated at the acquisition/transaction date (the "transaction date") over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the holder of the beneficial interest is the transferor, the initial investment would be the allocated

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carrying amount after application of the relative fair value allocation method required by Statement 125. The amount of accretable yield should not be displayed in the balance sheet. The Task Force further reached a consensus that the holder of a beneficial interest should continue to update the estimate of cash flows over the life of the beneficial interest. The consensus in this issue should be applied to the accounting for interest income and impairment of beneficial interests in securitization transactions meeting the scope criteria of this issue effective for all fiscal quarters beginning after March 15, 2001. The Company is presently assessing the effect of Issue No. 99-20 on the consolidated financial statements of the Company.

In September 2000, the FASB issued Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities -- A Replacement of FAS 125." This Statement replaces FAS 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." It revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but it carries over most of FAS 125's provisions without reconsideration. This Statement provides consistent standards for distinguishing transfers of financial assets that are sales from transfers that are secured borrowings. This Statement is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. The Company has adopted the provisions for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Because the Company's funding strategy is dependent upon the issuance of interest-bearing securities and the incurrence of debt, fluctuations in interest rates impact the Company's profitability. As a result, the Company employs various hedging strategies to limit certain risks of interest rate fluctuations. See "Management's Discussion and Analysis -- Hedging and Interest Rate Risk Management" and "Risk Factors -- We Are Subject to Interest Rate Fluctuations."

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

As a consumer finance company, the Company is subject to various consumer claims and litigation seeking damages and statutory penalties based upon, among other things, disclosure inaccuracies and wrongful repossession, which could take the form of a plaintiff's class action complaint. The Company, as the assignee of finance Contracts originated by dealers, may also be named as a co-defendant in lawsuits filed by consumers principally against dealers. Finally, the Company also is subject to other litigation common to the motor vehicle finance industry and businesses in general. The damages and penalties claimed by consumers and others in these types of matters can be substantial. The relief requested by the plaintiffs varies but includes requests for compensatory, statutory and punitive damages. The Company is currently a defendant in three consumer class action lawsuits. One such proceeding, served in 1999, in which the Company is a defendant, has been brought as a class action and is pending in the State of California. A class was certified in 2000; in the matter, the plaintiffs raise issues regarding the payment of dealer participation to dealers. The trial in this matter recently concluded and the Company is awaiting the court's decision. Another such proceeding, served in 2000, in which the Company is a defendant, was brought as a putative class action and is pending in the state of New Jersey. This case recently settled for a nominal amount and will be dismissed once the settlement documentation is finalized.

In another such consumer class action, filed and served in 1999, pending

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in Orange County Superior Court in the state of California, and entitled Jason Bollinger v. Onyx Acceptance Corporation (Action number 807831), the plaintiffs alleged that the Company sent defective post-repossession notices to certain California borrowers following the repossession or voluntary surrender of their vehicles. The Company, without admitting liability, entered into a settlement agreement with respect to this matter, and this agreement was approved by the court in October 2000. Under the terms of the settlement, the Company refunded certain amounts collected on deficiencies related to class members' accounts (in some instances, with interest) and paid a certain portion of the plaintiff's counsel fees and other amounts. Pursuant to the settlement, the monies from refund checks not cashed by the class members cannot be returned to the Company. In accordance with the settlement, these amounts shall be paid as follows: one-half to the plaintiff's counsel up to a negotiated cap, as an additional attorney's fee award, and the remainder to a non-profit youth soccer organization in Orange County, California where the Company's headquarters is located. One of the children of Mr. Hall, the Company's President and Chief Executive Officer, participates in this organization. Mr. Hall has also volunteered in certain capacities in this organization.

On January 25, 2000, a putative class action complaint was filed against the Company and certain of the Company's officers and directors alleging violations of Section 10(b) and 20(a) of the Securities and Exchange Act of 1934 arising from the Company's use of the cash-in method of measuring and accounting for credit enhancement assets in the financial statements. The matter is entitled D.

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Colin v. Onyx Acceptance Corporation, et al, in the U.S. District Court for the Central District of California (Case number SACV 00-0087 (GLT) (EEx)). The Company believes that its previous use of the cash-in method of measuring and accounting for credit enhancement assets was consistent with then current generally accepted accounting principles and accounting practices of other finance companies. As required by the Financial Accounting Standards Board's Special Report, "A Guide to Implementation of Statement 125 on Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, Second Edition," dated December 1998 and related statements made by the staff of the Securities and Exchange Commission, the Company retroactively changed the method of measuring and accounting for credit enhancement assets to the cash-out method and restated the Company's financial statements for 1996, 1997 and the first three fiscal quarters of 1998. In February 2001, an amended complaint was dismissed with prejudice by the court; the plaintiff has filed a notice of appeal.

Management believes that the Company has taken prudent steps to address the litigation risks associated with the Company's business activities. However, there can be no assurance that the Company will be able to successfully defend against all such claims or that the determination of any such claim in a manner adverse to the Company would not have a material adverse effect on the Company's automobile finance business.

In the opinion of management, the resolution of the proceedings described in this section will not have a material adverse effect on the Company's consolidated financial position, results of operations or liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted during the first quarter of the fiscal year covered by this Quarterly Report on Form 10-Q to a vote of security holders,

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through the solicitation of proxies or otherwise.

ITEM 5. OTHER INFORMATION

FORWARD LOOKING STATEMENTS

The preceding Management's Discussion and Analysis of the Company's Financial Condition and Results of Operations contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, which provides a "safe harbor" for these types of statements. This Quarterly Report on Form 10-Q contains forward-looking statements which reflect the current views of Onyx Acceptance Corporation with respect to future events and financial performance. These forward looking statements are subject to certain risks and uncertainties, including those identified below which could cause actual results to differ materially from historical results or those anticipated. Forward-looking terminology can be identified by the use of terms such as "may," "will," "expect," "anticipate," "estimate," "should" or "continue" or the negative thereof or other variations thereon or comparable terminology. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. Onyx Acceptance Corporation undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The following factors could cause actual results to differ materially from historical results or those anticipated: (1) the level of demand for auto contracts, which is affected by such external factors as the level of interest rates, the strength of the various segments of the economy, debt burden held by consumers and demographics of the lending markets of Onyx Acceptance Corporation; (2) continued dealer relationships; (3) fluctuations between consumer interest rates and the cost of funds; (4) federal and state regulation of auto finance operations; (5) competition within the consumer lending industry; (6) the availability and cost of securitization transactions and (7) the availability and cost of warehouse and residual financing.

RISK FACTORS

You should carefully consider the following risks in your evaluation of us and our Common Stock. The risks and uncertainties described below are not the only ones facing our Company. Additional risks and uncertainties, including but not limited to credit, economic, competitive, governmental and financial factors affecting our operations, markets, financial products, and services and other factors discussed in our filings with the Securities and Exchange Commission, may also adversely impact and impair our business. If any of these risks actually occur, our business, results of operations, cash flows or financial condition would likely suffer. In such case, the trading price of our common stock could decline, and you may lose all or part of the money you paid to buy our common stock.

We Need Substantial Liquidity.

We require a substantial amount of liquidity to operate our business. Among other things, we use such liquidity to:

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- acquire Contracts;
- pay dealer participation;
- pay securitization costs and fund related accounts;

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- settle hedge transactions;
- satisfy working capital requirements and pay operating expenses;
and
- pay interest expense.

A substantial portion of our revenues in any period is represented by gain on sale of Contracts generated by a securitization in such period, but the cash underlying such revenues is received over the life of the Contracts.

We have operated on a negative cash flow basis and expect to do so in the future as long as the volume of Contract purchases continues to grow. We have historically funded these negative operating cash flows principally through borrowings from financial institutions, sales of equity securities and sales of subordinated notes. We cannot assure you, however, that (1) we will have access to the capital markets in the future for equity, debt issuances or securitizations, or (2) financing through borrowings or other means will be available on acceptable terms to satisfy our cash requirements. If we are unable to access the capital markets or obtain acceptable financing, our results of operations, financial condition and cash flows would be materially and adversely affected.

We Depend on Warehouse Financing.

We depend on warehousing facilities with financial institutions to finance the purchase or origination of Contracts pending securitization. Our business strategy requires that such financing continue to be available during the warehouse period.

Whether the CP Facilities continue to be available to us depends on, among other things, whether we maintain a target net yield for the Contracts financed under the CP Facilities and comply with certain financial covenants contained in the sale and servicing agreements between us, as seller, and our wholly-owned special purpose finance subsidiaries, Finco or Recco, as applicable, as purchaser. These financial covenants include:

- a minimum ratio of net worth plus subordinated debt to total assets;
- a maximum ratio of credit enhancement assets to tangible net worth;
- earnings before interest, depreciation and taxes coverage ratio;
and
- minimum cash on hand.

We cannot assure you that our CP Facilities will be available to us or that they will be available on favorable terms. If we are unable to arrange new warehousing credit facilities or extend our existing credit facilities when they expire, our results of operations, financial condition and cash flows could be materially and adversely affected.

We Depend on Residual Financing.

When we sell our Contracts in securitizations, we receive cash and a residual interest in the securitized assets ("RISA"). The RISA represents the future cash flows to be generated by the Contracts in excess of the interest paid on the securities issued in the securitization and other costs of servicing the Contracts and completing the securitization. We typically use the RISA from

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each securitization as collateral to borrow cash to finance our operations. The amount of cash advanced by our lenders under our Residual Lines depends on a collateral formula that is determined in large part by how well our securitized Contracts perform. If our portfolio of securitized Contracts experienced higher delinquency and loss ratios than expected, then the amount of money we could borrow under the Residual Lines would be reduced. The reduction in availability under these Residual Lines could materially and adversely affect our

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operations, financial condition and cash flows. Additionally, we are subject, under the documentation governing the Residual Lines, to certain financial covenants.

We Depend on Securitizations to Generate Revenue.

We rely significantly upon securitizations to generate cash proceeds for repayment of our warehouse and our residual credit facilities and to create availability to purchase additional Contracts. Further, gain on sale of Contracts generated by our securitizations represents a significant portion of our revenues. Our ability to complete securitizations of our Contracts is affected by the following factors, among other things:

- conditions in the securities markets generally;
- conditions in the asset-backed securities market specifically;
- the credit quality of our portfolio of Contracts; and
- our ability to obtain credit enhancement.

If we were unable to profitably securitize a sufficient number of our Contracts in a particular financial reporting period, then our revenues for such period could decline and could result in lower net income or a loss for such period. In addition, unanticipated delays in closing a securitization could also increase our interest rate risk by increasing the warehousing period for our Contracts.

We Depend on Credit Enhancement.

From inception through March 31, 2001, each of our securitizations has utilized credit enhancement in the form of a financial guarantee insurance policy in order to achieve "AAA/Aaa" ratings. This form of credit enhancement reduces the cost of the securitizations relative to alternative forms of credit enhancements currently available to us. We cannot assure you that:

- we will be able to continue to obtain credit enhancement in any form from our current provider;
- we will be able to obtain credit enhancement from any other provider of credit enhancement on acceptable terms; or
- future securitizations will be similarly rated.

We also rely on financial guarantee insurance policies to reduce our borrowing cost under the CP Facilities. If our current provider's credit rating is downgraded or if it withdraws our credit enhancement, we could be subject to higher interest costs for our future securitizations and financing costs during the warehousing period. Such events could have a material adverse effect on our

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results of operations, financial condition and cash flows.

We Are Subject to Interest Rate Fluctuations.

Our profitability is largely determined by the difference, or "spread," between the effective rate of interest received by us on the Contracts acquired and the interest rates payable under our credit facilities during the warehousing period and for securities issued in securitizations.

Several factors affect our ability to manage interest rate risk. First, the Contracts are purchased or originated at fixed interest rates, while amounts borrowed under our credit facilities bear interest at variable rates that are subject to frequent adjustment to reflect prevailing rates for short-term borrowings. Our policy is to increase the buy rates we issue to dealerships or, for the Contracts we originate, to increase rates we make available to consumers for Contracts in response to increases in our cost of funds during the warehousing period. However, there is generally a time lag before such increased borrowing costs can be offset by increases in the buy rates for Contracts and, in certain instances, the rates charged by our competitors may limit our ability to pass through our increased costs of warehouse financing.

Second, the spread can be adversely affected after a Contract is purchased or originated and while it is held during the warehousing period by increases in the prevailing rates in the commercial paper markets. While the CP Facilities permit us to select maturities of up

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to 270 days for commercial paper, if we selected a shorter maturity or had a delay in completing a securitization, we would face this risk.

Third, the interest rate demanded by investors in securitizations is a function of prevailing market rates for comparable transactions and the general interest rate environment. Because the Contracts purchased or originated by us have fixed rates, we bear the risk of spreads narrowing because of interest-rate increases during the period from the date the Contracts are purchased until the pricing of our securitization of such Contracts. We employ a hedging strategy that is intended to minimize this risk and which historically has involved the execution of forward interest rate swaps or use of a pre-funding structure for our securitizations. However, we cannot assure you that this strategy will consistently or completely offset adverse interest-rate movements during the warehousing period or that we will not sustain losses on hedging transactions. Our hedging strategy requires estimates by management of monthly Contract acquisition volume and timing of our securitizations. If such estimates are materially inaccurate, then our gains on sales of Contracts, results of operations and cash flows could be materially and adversely affected.

We also have exposure to interest rate fluctuations under the Residual Lines. The interest rates are based on 30 day LIBOR and reset each month. In periods of increasing interest rates our cash flows, results of operations and financial condition could be adversely affected.

In addition, we have some interest rate exposure to falling interest rates to the extent that the interest rates charged on Contracts sold in a securitization with a pre-funding structure decline below the rates prevailing at the time that the securitization prices. Such a rate decline would reduce the interest rate spread because the interest rate on the notes and/or the certificates would remain fixed. This would negatively impact the gains on sale of Contracts and our results of operations and cash flows.

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We Will Be Adversely Affected When Contracts are Prepaid or Defaulted.

Our results of operations, financial condition, cash flows, and liquidity depend, to a material extent, on the performance of Contracts purchased, originated, warehoused, and securitized by us. A portion of the Contracts acquired by us may default or prepay during the warehousing period. We bear the risk of losses resulting from payment defaults during the warehousing period. In the event of payment default, the collateral value of the financed vehicle may not cover the outstanding Contract balance and costs of recovery. We maintain an allowance for credit losses on Contracts held during the warehousing period which reflects management's estimates of anticipated credit losses during such period. If the allowance is inadequate, then we would recognize as an expense the losses in excess of such allowance, and our results of operations could be adversely affected. In addition, under the terms of the CP Facilities, we are not able to borrow against defaulted Contracts.

Our servicing income can also be adversely affected by prepayment of or defaults under Contracts in the serviced portfolio. Our contractual servicing revenue is based on a percentage of the outstanding principal balance of such Contracts. Thus, if Contracts are prepaid or charged-off, then our servicing revenue will decline to the extent of such prepaid or charged-off Contracts.

The gain on sale of Contracts recognized by us in each securitization and the value of the retained interest in securitized assets ("RISA") in each transaction reflects management's estimate of future credit losses and prepayments for the Contracts included in such securitization. If actual rates of credit loss or prepayments, or both, on such Contracts exceed those estimated, the value of the RISA would be impaired. We periodically review our credit loss and prepayment assumptions relative to the performance of the securitized Contracts and to market conditions. Our results of operations and liquidity could be adversely affected if credit loss or prepayment levels on securitized Contracts substantially exceed anticipated levels. If necessary, we would write-down the value of the RISA through a reduction to servicing fee income. Further, any write down of RISA could reduce the amount available to us under our Residual Lines, thus requiring us to pay down amounts outstanding under the facilities or provide additional collateral to cure the borrowing base deficiency.

We Will Be Adversely Affected If We Lose Servicing Rights.

Our results of operations, financial condition and cash flows would be materially and adversely affected if any of the following were to occur:

- loss of the servicing rights under our sale and servicing agreements for the CP Facilities;
- loss of the servicing rights under the applicable pooling and servicing or sale and servicing agreement of a grantor trust or owner trust, respectively; or

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- a trigger event that would block release of future excess cash flows generated from the grantor trusts' or owner trusts' respective spread accounts.

We are entitled to receive servicing income only while we act as servicer under the applicable sales and servicing agreements or pooling and

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servicing agreements. Under the CP Facilities our right to act as servicer can be terminated by our lender or financial insurer, upon the occurrence of certain events.

Our Quarterly Earnings May Fluctuate.

Our revenues have fluctuated in the past and are expected to fluctuate in the future principally as a result of the following factors:

- the timing and size of our securitizations;
- variations in the volume of our Contract acquisitions;
- the interest rate spread between our cost of funds and the average interest rate of purchased Contracts;
- the effectiveness of our hedging strategies; and
- the investor rate for securitizations.

Any significant decrease in our quarterly revenues could have a material adverse effect on our results of operations, financial condition, cash flows and stock price.

We Depend on Key Personnel.

Our future operating results depend in significant part upon the continued service of our key senior management personnel, none of whom is bound by an employment agreement. Our future operating results also depend in part upon our ability to attract and retain qualified management, technical, and sales and support personnel for our operations. Competition for such personnel is intense. We cannot assure you that we will be successful in attracting or retaining such personnel. The loss of any key employee, the failure of any key employee to perform in his or her current position or our inability to attract and retain skilled employees, as needed, could materially and adversely affect our results of operations, financial condition and cash flows.

Our Industry is Highly Competitive.

Competition in the field of financing retail motor vehicle sales is intense. The automobile finance market is highly fragmented and historically has been serviced by a variety of financial entities including the captive finance affiliates of major automotive manufacturers, as well as banks, savings associations, independent finance companies, credit unions and leasing companies. Several of these competitors have greater financial resources than we do. Many of these competitors also have long-standing relationships with automobile dealerships, and offer dealerships or their customers other forms of financing or services not provided by us. Our ability to compete successfully depends largely upon our relationships with dealerships and the willingness of dealerships to offer those Contracts that meet our underwriting criteria to us for purchase. We cannot assure you that we will be able to continue to compete successfully in the markets we serve.

We May Be Harmed by Adverse Economic Conditions.

We are a motor vehicle consumer auto finance company whose activities are dependent upon the sale of motor vehicles. Our ability to continue to acquire Contracts in the markets in which we operate and to expand into additional markets is dependent upon the overall level of sales of new and used motor vehicles in those markets. A prolonged downturn in the sale of new and used motor vehicles, whether nationwide or in the California markets, could have an adverse impact upon us, our results of operations and our ability to

implement our business strategy.

The automobile industry generally is sensitive to adverse economic conditions both nationwide and in California, where we have our largest single-state exposure. Periods of rising interest rates, reduced economic activity or higher rates of unemployment generally result in a reduction in the rate of sales of motor vehicles and higher default rates on motor vehicle contracts. We cannot assure you

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that such economic conditions will not occur, or that such conditions will not result in severe reductions in our revenues or the cash flows available to us to permit us to remain current on our credit facilities.

We Are Subject to System Risks.

The Company is currently in the process of converting from an external service provider for its loan accounting and collections system to an in-house system. If this process is not completed in a successful manner, or if issues with the in-house system arise in the future, we may be unable to fund Contracts and service the outstanding portfolio. The failure of this process could materially and adversely affect our results of operations, financial condition and cash flows.

We Are Subject to Many Regulations.

Our business is subject to numerous federal and state consumer protection laws and regulations, which, among other things:

- require us to obtain and maintain certain licenses and qualifications;
- limit the interest rates, fees and other charges we are allowed to charge;
- limit or prescribe certain other terms of our Contracts;
- require specific disclosures; and
- define our rights to repossess and sell collateral.

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

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

We Are Subject to Litigation Risks.

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We are party to various legal proceedings, similar to actions brought against other companies in the motor vehicle finance industry and other businesses. Companies in the motor vehicle finance industry have been named as defendants in an increasing number of class action lawsuits brought by purchasers of motor vehicles claiming violation of various federal and state consumer credit and similar laws and regulations. We are defendants in three such consumer class action lawsuits, one of which was served on us in 2000. One such proceeding, served in 1999, in which we are a defendant, has been brought as a putative class action and is pending in the State of California. A class was certified in 2000; in the matter, the plaintiffs raise issues regarding the payment of dealer participation to dealers. The trial in this matter recently concluded and we are awaiting the court's decision. Another such proceeding, served in 2000, in which we are a defendant, was brought as a putative class action and is pending in the state of New Jersey. This case recently settled for a nominal amount and will be dismissed once the settlement documentation is finalized.

In another such consumer class action, filed and served in 1999, pending in Orange County Superior Court in the state of California, and entitled Jason Bollinger v. Onyx Acceptance Corporation (Action number 807831), the plaintiffs alleged that we sent defective post-repossession notices to certain California borrowers following the repossession or voluntary surrender of their vehicles. Without admitting liability, we entered into a settlement agreement with respect to this matter, and this agreement was approved by the court in October 2000. Under the terms of the settlement, we refunded certain amounts collected on deficiencies related to class members' accounts (in some instances, with interest) and paid a certain portion of the plaintiff's counsel fees and other amounts. Pursuant to the settlement, the monies from refund checks not cashed by the class members cannot be returned to us. In accordance with the settlement, these amounts shall be paid as follows: one-half to the plaintiff's counsel up to a

negotiated cap, as an additional attorney's fee award, and the remainder to a non-profit youth soccer organization in Orange County, California where the our headquarters is located. One of the children of Mr. Hall, the Company's President and Chief Executive Officer, participates in this organization. Mr. Hall has also volunteered in certain capacities in this organization.

On January 25, 2000, a putative class action complaint was filed against us and certain of our officers and directors alleging violations of Section 10(b) and 20(a) of the Securities and Exchange Act of 1934 arising from our use of the cash-in method of measuring and accounting for credit enhancement assets in the financial statements. The matter is entitled D. Colin v. Onyx Acceptance Corporation, et al, in the U.S. District Court for the Central District of California (Case number SACV 00-0087 (GLT) (EEx)). We believe that our previous use of the cash-in method of measuring and accounting for credit enhancement assets was consistent with then current generally accepted accounting principles and accounting practices of other finance companies. As required by the Financial Accounting Standards Board's Special Report, "A Guide to Implementation of Statement 125 on Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities, Second Edition," dated December 1998 and related statements made by the staff of the Securities and Exchange Commission, we retroactively changed the method of measuring and accounting for credit enhancement assets to the cash-out method and restated our financial statements for 1996, 1997 and the first three fiscal quarters of 1998. In February 2001, an amended complaint was dismissed with prejudice by the court; the plaintiff has filed a notice of appeal.

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

ITEM 6. EXHIBITS AND REPORTS OF FORM 8-K

(a) Exhibits

| EXHIBIT NUMBER ----- | EXHIBIT TITLE ----- |
|----------------------------|--|
| 10.107 | Onyx Acceptance Corporation Non-Qualified Deferred Compensation Plan |
| 10.108 | The Onyx Acceptance Corporation Non-Qualified Deferred Compensation Plan Trust Agreement |
| 21.1 | Subsidiaries of the Registrant. |

(b) Reports on Form 8-K

None.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

ONYX ACCEPTANCE CORPORATION

By: /s/ JOHN W. HALL

John W. Hall
President and Principal
Executive Officer

Date: March 14, 2001

By: /s/ DON P. DUFFY

Don P. Duffy
Executive Vice President and
Principal Financial Officer

Date: March 14, 2001

EXHIBIT INDEX

| EXHIBIT NUMBER ----- | EXHIBIT TITLE ----- |
|----------------------------|---|
| 10.107 | Onyx Acceptance Corporation Non-Qualified Deferred Compensation Plan |
| 10.108 | The Onyx Acceptance Corporation Non-Qualified Deferred Compensation Plan Trust Agreement |
| 21.1 | Subsidiaries of the Registrant. |