

ONYX ACCEPTANCE CORP

Form 10-Q/A

September 23, 2003

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

**Form 10-Q/A**

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

**For the quarterly period ended September 30, 2002**

or

- o **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 Number)*

**Onyx Acceptance Corporation**  
**27051 Towne Centre Drive**  
**Foothill Ranch, CA 92610**  
**(949) 465-3900**  
*(Address and telephone number of principal executive offices)*

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

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

As of November 14, 2002 there were 5,086,793 shares of registrant's Common Stock, par value \$.01 per share outstanding.

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**ONYX ACCEPTANCE CORPORATION**  
**QUARTERLY REPORT ON FORM 10-Q/A,**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2002**

This amendment on Form 10-Q/A amends the Quarterly Report of Onyx Acceptance Corporation (the Company) on Form 10-Q previously filed with the Securities and Exchange Commission on November 14, 2002 for the quarter and nine months ended September 30, 2002. This amendment is filed in connection with the restatement of our results of operations for the year ended December 31, 2002 in our Annual Report on Form 10-K/A for 2002. The circumstances necessitating the restatement and their effects on the quarter and nine months ended September 30, 2002 are more fully described in note 2 of the Notes to Condensed Consolidated Financial Statements.

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**ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**

	<u>September 30,</u> <u>2002</u>	<u>December 31,</u> <u>2001</u>
	(Restated)* (Dollars in thousands) (Unaudited)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 104	\$ 1,135
Restricted cash	4,785	
Credit enhancement assets, at fair value	180,440	184,300
Contracts held for sale	213,605	189,265
Contracts held for investment (net of allowance)	4,521	2,259
Other assets	9,241	9,326
	<u>          </u>	<u>          </u>
Total assets	\$412,696	\$386,285
	<u>          </u>	<u>          </u>
<b>LIABILITIES</b>		
Accounts payable	\$ 33,117	\$ 27,024
Debt:		
Warehouse lines	214,008	190,008
Excess service lines	52,359	68,355
Subordinated debt/other	21,471	16,232
	<u>          </u>	<u>          </u>
Total debt	287,838	274,595
Other liabilities	28,890	24,965
	<u>          </u>	<u>          </u>
Total liabilities	349,845	326,584
<b>EQUITY</b>		
Common stock		
Par value \$.01 per share; authorized 15,000,000 shares; issued and outstanding 5,086,793 as of September 30, 2002 and 5,078,046 as of December 31, 2001	51	51
Paid in capital	32,651	32,647
Retained earnings	27,069	25,960
Accumulated other comprehensive income, net of tax	3,080	1,043
	<u>          </u>	<u>          </u>
Total equity	62,851	59,701
	<u>          </u>	<u>          </u>
Total liabilities and equity	\$412,696	\$386,285
	<u>          </u>	<u>          </u>

\*Refer to Note 2

See the accompanying notes to the condensed consolidated financial statements.



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**ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2001	2002	2001
	(Restated)*		(Restated)*	
	(Dollars in thousands, except per share amounts)			
<b>Revenues:</b>				
Interest income	\$ 10,145	\$ 7,779	\$ 28,006	\$ 19,776
Interest expense	2,845	2,849	9,003	10,776
<b>Net Interest Income</b>	<b>7,300</b>	<b>4,930</b>	<b>19,003</b>	<b>9,000</b>
Gain on sale of contracts, net	3,255	6,591	9,932	26,167
Service fee income	12,842	13,990	39,472	43,408
<b>Total Revenues</b>	<b>23,397</b>	<b>25,511</b>	<b>68,407</b>	<b>78,575</b>
<b>Expenses:</b>				
Provision for credit losses	818	502	(461)	966
Interest expense-other	1,225	812	3,154	3,032
<b>Operating Expenses:</b>				
Salaries and benefits	13,549	13,228	40,998	39,895
Systems and servicing	777	476	2,156	3,573
Telephone and data lines	1,056	1,201	2,541	3,680
Depreciation	806	1,094	2,676	3,568
General and administrative expenses	4,592	5,957	15,449	16,989
<b>Total Operating Expenses</b>	<b>20,780</b>	<b>21,956</b>	<b>63,820</b>	<b>67,705</b>
<b>Total Expenses</b>	<b>22,823</b>	<b>23,270</b>	<b>66,513</b>	<b>71,703</b>
<b>Income before Income Taxes</b>	<b>574</b>	<b>2,241</b>	<b>1,894</b>	<b>6,872</b>
Income Taxes	238	899	785	2,821
<b>Net Income</b>	<b>\$ 336</b>	<b>\$ 1,342</b>	<b>\$ 1,109</b>	<b>\$ 4,051</b>
Net Income per share Basic	\$ 0.07	\$ 0.27	\$ 0.22	\$ 0.81
Net Income per share Diluted	\$ 0.07	\$ 0.25	\$ 0.21	\$ 0.78
Basic Shares Outstanding	5,086,793	5,047,292	5,084,914	5,008,767
Diluted Shares Outstanding	5,142,298	5,354,351	5,194,178	5,214,455

\*Refer to Note 2

See the accompanying notes to the condensed consolidated financial statements.





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**ONYX ACCEPTANCE CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2002	2001
	(Dollars in thousands)	
	(Unaudited)	
<b>Operating Activities:</b>		
Net cash used in operating activities	\$ (9,067)	\$ (44,552)
<b>Investing Activities:</b>		
Cash used for purchases of property and equipment	(998)	(2,140)
<b>Financing Activities:</b>		
Proceeds from exercise of employee options	4	47
Payments on capital lease obligations	(331)	
Proceeds from lease refinance	900	206
Payments on residual lines of credit	(102,474)	(13,884)
Proceeds from drawdown on residual lines of credit	86,480	32,600
Paydown of warehouse lines related to securitizations	(900,223)	(925,310)
Proceeds from warehouse lines	924,223	958,305
Proceeds from issuance of subordinated debt	8,120	
Principal payments on subordinated debt	(2,880)	(2,427)
	13,819	49,537
Net cash provided by financing activities		
Increase in cash and cash equivalents	3,754	2,845
Cash and cash equivalents at beginning of period	1,135	3,130
	\$ 4,889	\$ 5,975
Cash and cash equivalents at end of period		

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**

**Note 1 Nature of Operations**

Onyx is a specialized consumer finance company engaged in the purchase, origination, securitization and servicing of Contracts originated by franchised and select independent automobile dealerships in the United States. The Company focuses its efforts on acquiring Contracts that are collateralized by late model used and, to a lesser extent, new automobiles, that are entered into with purchasers whom the Company believes have a favorable credit profile. Since commencing the purchase of Contracts in February 1994, the Company has acquired more than \$8.3 billion in Contracts and currently has relationships with over 10,600 dealerships.

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 excess cash flows generated by owner trusts, and earns fees from servicing the securitized Contracts.

**Reclassification**

Certain amounts in the prior quarter and year to date condensed consolidated financial statements have been reclassified to conform to the corresponding 2002 presentation.

**Note 2 Restatement**

The Company revised the amount of loan premium amortization on Contracts acquired in connection with clean up calls exercised on the Company's securitization pools. The amount previously reported by the Company understated the amount of premium amortization in the quarter and nine months ending September 30, 2002 by \$153 thousand. In addition, the Company is recording \$370 thousand of impairment recorded on certain trusts, previously recorded in the fourth quarter of 2002, due to an erroneous calculation.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2002	2002	2002	2002
	As reported	Restated	As reported	Restated
	(Dollars in thousands, except per share amounts)			
Interest income	\$ 10,298	\$ 10,145	\$ 28,159	\$ 28,006
Net interest income	7,453	7,300	19,156	19,003
Gain on sale of contracts, net	3,625	3,255	10,302	9,932
Total Revenues	23,920	23,397	68,930	68,407
Income before Income Taxes	1,097	574	2,417	1,894
Income Taxes	455	238	1,002	785
	\$ 642	\$ 336	\$ 1,415	\$ 1,109
Net Income per share Basic	\$ 0.13	\$ 0.07	\$ 0.28	\$ 0.22
Net Income per share Diluted	\$ 0.12	\$ 0.07	\$ 0.27	\$ 0.21

As of September 30, 2002	As of September 30, 2002
As reported	Restated

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	(Dollars in thousands)	
Credit enhancement assets, at fair value	180,870	180,440
Contracts held for sale	213,698	213,605
	<u>          </u>	<u>          </u>
Total assets	413,219	412,696
	<u>          </u>	<u>          </u>
Other liabilities	29,107	28,890
	<u>          </u>	<u>          </u>
Total liabilities	350,062	349,845
Retained earnings	27,375	27,069
Total equity	63,157	62,851
	<u>          </u>	<u>          </u>
Total liabilities and equity	\$413,219	\$412,696
	<u>          </u>	<u>          </u>

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**Note 3 Basis of Presentation**

The condensed consolidated financial statements included herein are unaudited and have been prepared by Onyx Acceptance Corporation ( Onyx or the Company ) in accordance with generally accepted accounting principles for interim financial reporting and Securities and Exchange Commission regulations. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the regulations. In the opinion of management, the financial statements reflect all adjustments (all of a normal and recurring nature) which are necessary for a fair statement of the financial position, results of operations and cash flows for the interim period. Operating results for the three and nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. The condensed consolidated financial statements should be read in conjunction with the audited financial statements and footnotes thereto for the year ended December 31, 2001 included in the Company s 2001 Annual Report on Form 10-K.

*Use of Estimates*

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

**Note 4 Restricted Cash**

Restricted cash represents amounts held in reserve accounts providing credit enhancement on the Company s outstanding on balance sheet residual securitization.

**Table of Contents****Note 5 Contracts Held for Sale**

Contracts held for sale are carried at the lower of cost or market value on an aggregate basis. Contracts held for sale include Contracts reacquired upon the exercise of clean up calls and available for sale as part of future securitizations. At the time of such calls, any unamortized RISA balance is reclassified from credit enhancements assets and accounted for as loan premium on the reacquired loans. Loan premiums are amortized in a manner that results in a constant effective yield over the remaining life of the loans. In amortizing loan premium, the Company anticipates prepayments will occur at a rate consistent with that utilized in valuing its residual interests (approximately 1.75% per month) over the estimated remaining contractual life of the loans at the date such loans are reacquired. If the Company's actual prepayment experience differs materially from anticipated prepayment experience, the Company will recalculate the effective yield to reflect actual payments to date and anticipated future payments. The unamortized loan premium is adjusted, through a charge or credit to interest income, to the amount that would have existed had the new effective yield been applied since the acquisition of the loans.

	September 30, 2002	December 31, 2001
	(In thousands)	
Gross contracts held for sale (1)	\$ 218,314	\$ 193,879
Less unearned interest	(1,608)	(2,164)
Contracts held for sale	216,706	191,715
Dealer participation (net)	(3,101)	(2,450)
<b>Total</b>	<b>\$ 213,605</b>	<b>\$ 189,265</b>

(1) Gross Contracts held for sale includes loan premiums of \$0.2 million as of September 30, 2002.

**Note 6 Contracts Held for Investment**

Contracts held for investment are net of a \$1.9 million allowance for probable losses for September 30, 2002 and a \$1.3 million allowance for December 31, 2001. Amounts held for investment include Contracts that do not qualify for Contract securitizations as a result of delinquency status or minimum balance.

**Note 7 Credit Enhancement Assets**

SFAS 140 requires that following a transfer of financial assets, an entity is to recognize the assets it controls and the liabilities it has incurred, and derecognize assets for which control has been surrendered and liabilities that have been extinguished.

Credit enhancement assets consisted of the following:

	September 30, 2002	December 31, 2001
	(In thousands)	
Trust receivable	\$ 3,500	\$ 3,980
RISA	176,940	180,320
<b>Total</b>	<b>\$ 180,440</b>	<b>\$ 184,300</b>

Trust receivables represents initial deposits in spread accounts.

Retained interest in securitized assets ( RISA ) is capitalized upon securitization of Contracts, and represents 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

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taking the difference between the weighted average 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 at the time of securitization are utilized to project future cash flows upon securitization and are based on historical experience. In calculating the gain on sale, the Company uses a 1.75% prepayment rate for all outstanding securitizations resulting in an average Contract life range of 1.6 to 1.7 years. Net credit loss assumptions at the time of securitization ranged from 3.5% to 4.7% cumulative depending upon the credit statistics of the underlying portfolio to be securitized. 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. The fair value of the RISA at quarter-end is calculated by discounting the excess spread at a rate management believes to be representative of market at the time of securitization. Historically,

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this rate has equaled 3.5% over the weighted average security rate paid to investors. As a result of recent market transactions during the first quarter of 2002, Management revised the assumptions used in deriving an appropriate discount rate. Management has developed a systematic methodology that is a function of both market benchmark rates and the seasoning of a securitization's cash flow. As of September 30, 2002, the discount rate used for valuing RISA ranged from 8.8% to 11.3%, net loss assumptions ranged from 3.8% to 5.8% cumulative and prepayment rate assumptions ranged from 1.65% to 1.85%. For the securitization executed during the third quarter of 2002, Management applied a discount rate of 11.3% and a cumulative loss assumption of 3.8%.

Emerging Issues Task Force ( EITF ) 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets established new income and impairment recognition standards for interests in certain securitized assets. The Company adopted EITF 99-20 effective April 1, 2001. Under the provisions of EITF 99-20, the holder of beneficial interests should recognize the excess of all estimated cash flows attributable to the beneficial interest estimated at the acquisition date over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method. If the estimated cash flows change, then the holder of the beneficial interest should recalculate the accretable yield and adjust the periodic accretion recognized as income prospectively. If the fair value of a beneficial interest has declined below its carrying amount, an other-than-temporary decline is considered to exist if there has been a decline in the present value of estimated future cash flows and the difference between the carrying value and fair value of the beneficial interest is recorded as an impairment loss through the income statement. During the quarter and nine-month period ended September 30, 2002, the Company recorded a \$5.5 million and \$9.9 million pre-tax impairment charge on certain pre-2001 securitizations stemming from reduced cash flows and higher loss and delinquency rates than initially projected at the inception of the transactions. These impairment charges are reflected in the gain on sale line item in the income statement.

Prior to the adoption of EITF 99-20, the balance of RISA was amortized against actual excess spread income earned on a monthly basis over the expected repayment life of the underlying Contracts. The adoption of EITF 99-20 resulted in amounts previously recognized as service fee income being recognized as interest income. In initially valuing the RISA, the Company reduces projected cash flows for probable credit losses by establishing an off balance sheet allowance for estimated credit losses over the life of the underlying Contracts. The allowance is based upon historical experience and management's estimate of future performance regarding credit losses. 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 RISA 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 financial guaranty 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.

	September 30, 2002	December 31, 2001
	(In thousands)	
Estimated net undiscounted RISA earnings	\$ 320,871	\$ 324,162
Off balance sheet allowance for losses	(107,212)	(110,347)
Discount to present value	(36,719)	(33,495)
Retained interest in securitized assets	\$ 176,940	\$ 180,320
Outstanding balance of contracts sold through securitizations	\$2,679,062	\$2,635,042

**Note 8 Net Income Per Share**

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

Three Months Ended September 30,		Nine Months Ended September 30,	
2002	2001	2002	2001
(In thousands, except \$ per share)			

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Net Income	\$ 336	\$ 1,342	\$ 1,109	\$ 4,051
	■	■	■	■
Weighted average shares outstanding	5,087	5,047	5,085	5,009
Net effect of dilutive stock options/warrants	55	307	109	205
	■	■	■	■
Diluted weighted average shares outstanding	5,142	5,354	5,194	5,214
	■	■	■	■
Net income per share:				
Basic EPS	\$ 0.07	\$ 0.27	\$ 0.22	\$ 0.81
	■	■	■	■
Diluted EPS	\$ 0.07	\$ 0.25	\$ 0.21	\$ 0.78
	■	■	■	■

At September 30, 2002, there were 1.99 million options and 184 thousand warrants outstanding.



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### **Note 9 Contingencies**

The Company is party to various legal proceedings similar to actions brought against other companies in the motor vehicle finance and other industries, which 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 10 Subsequent Events**

In October of 2002, the Company securitized \$450 million in Contracts.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The Company revised the amount of loan premium amortization on Contracts acquired in connection with clean up calls exercised on the Company's securitization pools. The amount previously reported by the Company understated the amount of premium amortization in the quarter and nine months ending September 30, 2002 by \$153 thousand. In addition, the Company is recording \$370 thousand of impairment recorded on certain trusts, previously recorded in the fourth quarter of 2002.

As indicated in Note 2 to the Company's financial statements, all such amounts contained in Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) reflect the restatement. The Company has only updated information in MD&A related to the restatement.

### **Overview**

Onyx is a specialized consumer finance company engaged in the purchase, origination, securitization and servicing of Contracts originated by franchised and select independent automobile dealerships in the United States. The Company focuses its efforts on acquiring Contracts that are collateralized by late model used and, to a lesser extent, new automobiles, that are entered into with purchasers whom the Company believes have a favorable credit profile. Since commencing the purchase of Contracts in February 1994, the Company has acquired more than \$8.3 billion in Contracts and currently has relationships with over 10,600 dealerships. The Company has expanded its operations from a single office in California to 18 Auto Finance Centers serving many regions of the United States.

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. Net interest income is the difference between the income earned on interest earning assets and the interest paid on interest bearing liabilities. Upon the securitization and sale of Contracts, the Company recognizes a gain on sale of Contracts, receives excess cash flows generated by owner trusts, and earns fees from servicing the securitized Contracts.

### ***Critical Accounting Policies***

Critical accounting policies are an integral part of the compilation of the Company's financial condition and results of operations. Critical accounting policies require complicated and often intricate calculations and judgments because they often rely on estimates based on continually changing market conditions. The following is a summary of accounting policies we consider critical.

### ***Retained Interest in Securitized Assets ( RISA )***

RISA represents 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 weighted average 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. The estimates that Management makes during the execution of the securitization relate to the expected prepayment rate of the Contracts in the transaction, the discount rate to be applied to the cash flows and the amount of cumulative losses that will be experienced by the Contracts that are sold in the transaction. As these estimates are made at the inception of the transaction, they will have a degree of uncertainty as the transaction ages. A major variable to these estimates relates to the general state of the economy at any given time and its effect on the performance of the Contracts in the transaction. During 1999, the Emerging Issues Task Force ( EITF ) issued EITF 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets. EITF 99-20 established income and impairment recognition standards for interests in certain securitized assets. Under the provisions of EITF 99-20, the holder of beneficial interests should recognize the excess of all estimated cash flows attributable to the beneficial interest estimated at

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acquisition date over the initial investment (the accretable yield) as interest income over the life of the beneficial interest using the effective yield method.

RISA is classified in a manner similar to available for sale assets and as such is marked to market each quarter. Market value changes are calculated by discounting the estimated cash flows using a current market discount rate. Each quarter Management reviews its estimates of the cash flows and adjusts any that are inconsistent with its current estimates. If the effect of the new estimates reduces the present value of the cash flows and if the fair market value has declined below the carrying amount of the transaction, Management will record an impairment loss on the transaction. If the new estimated present value has declined but the carrying amount remains below the fair value, any change in the market value of the RISA is reported as a separate component of shareholders' equity on the consolidated statements of financial condition as accumulated other comprehensive income (loss), net of applicable taxes.

### ***Hedging Activities***

The Contracts originated and held by us earn interest at a fixed rate and, accordingly, we have exposure to changes in interest rates during the warehouse period. We therefore employ a hedging strategy that is intended to minimize the risk of interest rate fluctuations. Such transactions involve the execution of forward interest rate swaps and/or the use of a pre-funding structure for securitizations. Management monitors the hedging activities on a frequent basis to ensure that the value of hedges, their correlation to the Contracts being hedged and the amounts being hedged continue to provide effective protection against interest rate risk. Our hedging strategy requires estimates of monthly Contract acquisition volume and timing of securitizations. The amount and timing of hedging transactions are determined by senior management, and are based upon the amount of Contracts purchased and the interest rate environment.

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

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

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 the securitization (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.

## **Results of Operations**

### ***Net Interest Income***

Net interest income consists primarily of 1) the difference between the finance revenue earned on Contracts held on balance sheet during the warehousing period and the interest costs associated with the Company's borrowings to purchase such Contracts; and 2) the difference between income accreted on RISA and the interest costs associated with residual line borrowings secured by RISA.

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Net interest income increased to \$7.3 million for the quarter ended September 30, 2002, from \$4.9 million for the same period in 2001. For the nine-month period, net interest income increased to \$19.0 million, compared to \$9.0 million for the same period in 2001. The increases were principally due to an increase in interest income generated from the Company's RISA and a decrease in interest expense on the Company's commercial paper line.

The increase in net interest income was also due to an increase in yields realized under the provisions of Emerging Issues Task Force (EITF) 99-20, which requires amounts previously recognized as excess service fee income to be recognized as interest income. For the quarter ended September 30, 2002 total income recognized under EITF 99-20 was approximately \$5.4 million, versus approximately \$4.0 million for the same period in 2001. For the nine months ended September 30, 2002, income recognized under EITF 99-20 was \$13.6 million, compared to \$5.9 million for the same period in 2001. There was no EITF 99-20 income recognized in the first quarter of 2001, as the provisions did not become effective until April 1, 2001. Interest expense associated with borrowings under residual lines secured by RISA totaled approximately \$1.8 million for the quarter, compared to \$0.9 million for the quarter ended September 30, 2001. For the nine-month period ended September 30, 2002, interest expense under the residual lines was \$5.5 million, compared to \$1.7 million for the same period in 2001. The Company classifies this interest expense as a component of net interest income to better match RISA revenues with RISA-secured expenses.

Total commercial paper interest expense for the quarter was \$1.0 million, compared to \$1.9 million for the same period in 2001. For the nine-month periods ended September 30, 2002 and 2001, interest expense on the Company's commercial paper line was \$3.5 million and \$9.0 million respectively. The weighted average interest rate paid on the Company's commercial paper line for the quarter was approximately 1.8%, compared to 3.7% for the same period in 2001. For the nine months ended September 30, 2002, the weighted average rate remained at approximately 1.8%, compared to 4.7% for the same period in 2001. Finance revenue earned on Contracts held on for sale and investment was \$4.5 million and \$3.8 million for the quarters ended September 30, 2002 and 2001, respectively. For the nine months ended September 30, 2002 and 2001, finance revenue was \$12.3 million and \$13.8 million, respectively. The average balance of Contracts held on balance sheet was \$158.0 million and \$109.1 million for the quarters ended September 30, 2002 and 2001, respectively. For the nine-month period ended September 30, 2002 and 2001, the average balance of Contracts held on balance sheet were \$147.4 million and \$164.0 million, respectively.

The following table illustrates the components of net interest income:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2002	2001	2002	2001
<b>Interest Income</b>				
Interest Income - Contracts	\$ 4,304	\$ 3,763	\$ 12,311	\$ 13,813
Interest Income - RISA/Other	5,841	4,016	15,695	5,963
Total interest income	10,145	7,779	28,006	19,776
<b>Interest Expense</b>				
Commercial paper	1,077	1,943	3,453	9,027
Residual lines	1,768	906	5,550	1,749
Total interest expense	2,845	2,849	9,003	10,776
<b>Net interest income</b>	<b>\$ 7,300</b>	<b>\$ 4,930</b>	<b>\$ 19,003</b>	<b>\$ 9,000</b>

**Gain on Sale of Contracts**

The Company computes a gain on sale with respect to Contracts securitized based on the present value of the estimated future excess cash flows to be received from such Contracts using a market discount rate. Gain on sale is recorded as a credit enhancement asset on the statement of financial condition. The gain recorded in the statement of income is adjusted for prepaid dealer participation, issuance costs and the gain or loss on the termination of the cash flow hedge. The gain on the sale of Contracts is affected by the amount of Contracts securitized and the net interest rate spread on those Contracts.

The Company completed one securitization qualifying for sale treatment totaling \$450.0 million during the quarter ended September 30, 2002, resulting in a gain of \$8.8 million, or 2.0% of the dollar amount of Contracts securitized, compared to a securitization of \$400.0 million in the third quarter of 2001, resulting in a gain of \$6.6 million or 1.6% of the dollar amount securitized. For the nine-month period ended

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September 30, 2002, the Company securitized a total of \$1.2 billion, and recorded a combined gain of \$19.0 million, or 1.6% of the amount securitized, compared to \$1.2 billion securitized in 2001 and a gain of \$26.2

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million or 2.2% of the amount securitized. During the second quarter of 2002, the Company elected to refinance its residual cash flow securitization, which was originally executed during the first quarter of 2000, and recorded a gain of approximately \$0.8 million.

The increase in the gain as a percentage of the Contracts securitized for the third quarter of 2002 was principally due to a wider net interest rate spread realized on the third quarter securitization. The weighted average net interest rate spread for the securitization executed during the third quarter of 2002 was 1.89%, compared to 1.57% for the same period in 2001. The net interest rate spread is the difference between the weighted average Contract rate of the securitized assets, and the weighted average investor rate inclusive of all costs related to the securitization transaction and net of projected credit losses. The increase in spread was principally due to a reduction in the loss assumption for the third quarter securitization compared to the securitization executed during the third quarter of 2001. Management believes the reduction in the loss assumption is warranted, given the performance of securitizations executed after 2000, which have outperformed Management's original credit assumptions. Interest rate spread is also affected by product mix, general market conditions and overall market interest rates. The risks inherent in interest rate fluctuations are partially reduced through hedging activities. For the nine-month period ended September 30, 2002, the weighted average net interest rate spread decreased to 1.62%, compared to 1.98% for the same period in 2001.

During the quarter and nine-month period ended September 30, 2002, the Company recorded a \$5.5 million and \$9.9 million pre-tax impairment charge, respectively, on its RISA asset. While the Company has experienced a significant reduction in its overall delinquency rates since December 31, 2001, certain pre-2001 securitizations experienced higher losses and delinquency rates than initially projected at the inception of the transactions, which have been impacted by the slow-down in the economy and the lower credit quality of the borrower. The impairment charges have been recorded to reduce the gain on sale recorded in the three and nine-month periods ended September 30, 2002.

***Service Fee Income***

Contractual servicing fee income is earned at a rate of 1.0% per annum on the outstanding principal balance of Contracts securitized. Servicing fee income is related to the size of the serviced portfolio and also includes investment interest, late fees, extension fees, document fees and other fees charged to customer accounts.

Servicing fee income was \$12.8 million and \$39.5 million for the quarter and nine-month period ended September 30, 2002, compared to \$14.0 million and \$43.4 million for the same periods in 2001. Included in the first three months of 2001, was approximately \$1.1 million of excess service fee income recorded prior to the adoption of EITF 99-20. Excluding the effects of EITF 99-20, service fee income for the nine-month period of 2001 would have been approximately \$40.8 million. The reduction in service fee income was principally due to a reduction in investment income received on trust cash accounts during the current periods reported.

***Provision for Credit Losses***

The Provision for credit losses represents estimated net credit losses incurred on Contracts held on balance sheet. The provision for credit losses was \$0.8 million and \$(0.5) million for the three and nine-month period ended September 30, 2002, respectively, compared to \$0.5 million and \$1.0 million for the same periods in 2001. The provision for credit losses for the nine-month period ended September 30, 2002 reflects a sales tax refund applied during the second quarter of 2002 in the amount of approximately \$2.0 million. The refund has been treated as a recovery as it relates to pro-rata sales taxes paid by the Company in financing the purchases of vehicles for which the related Contracts have been previously charged-off.

***Other Interest Expense***

Other interest expense was \$1.2 million for the period ending September 30, 2002, compared to \$0.8 million for the same period in 2001. For the nine-month period, other interest expense was \$3.2 million, compared to \$3.0 million for the same period in 2001. Other interest expense includes interest and amortized fees on the Company's subordinated debt, capital lease obligations and hedging activities under the guidelines of FAS 133. For the first quarter of 2001, the Company also included interest of approximately \$0.9 million from its residual lines of credit. For 2002, the Company has classified interest expense from its residual lines of credit under net interest income as a means to match income generated under the provisions of EITF 99-20. The increase in interest expense for the third quarter and nine-month period ended September 30, 2002 was principally due to FAS 133 hedge ineffectiveness. Charges related to the guidelines of FAS 133 were \$0.3 million and \$0.8 million for the quarter and nine-month period ended September 30, 2002, compared to \$0.2 million and \$0.3 million for the same periods in 2001, respectively. The increases were

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principally due to increases in the ineffective portion of the unrealized loss on cash flow hedges due to more rapid interest rate declines throughout 2002 versus 2001 and the change in value of the forward premium between the swap execution date and the financial reporting date.

### ***Operating Expenses***

The Company has made a significant effort to control operating expenses through renegotiation of existing service contracts beginning in 2000, and has effectively reduced its operating expenses as a percent of the serviced portfolio as a result of these efforts. Total operating expenses as a percent of the average serviced portfolio decreased to 2.96% for the nine months ended September 30, 2002, compared to 3.22% for the nine months ended September 30, 2001. Total operating expenses for the quarter ended September 30, 2002 decreased to \$20.8 million, compared to \$22.0 million for the same period in 2001. For the nine-month period ended September 30, 2002, total operating expenses decreased by 5.7%, or \$3.9 million versus the same period in 2001. Significant decreases in operating expense categories for the nine-month period were realized in systems and servicing expense, telephone and utilities expense and legal and professional expense. The combined reduction of the three expense categories versus 2001 was approximately \$4.0 million.

The Company incurred salary and benefit expenses of \$13.5 million for the quarter ended September 30, 2002, compared to \$13.2 million for the same period in 2001. For the nine-month period ended September 30, 2002, total salary and benefit expense was \$41.0 million, compared to \$39.9 million for the same period in 2001. The increase for the three and nine-month period is principally due to normal merit increases and higher health care costs in connection with the Company's benefit plans. Increases in salary and benefit expenses were partially offset by decreases in charges in connection with the services of temporary staff agencies. These charges are included as a component of total salaries and benefits displayed in the income statement. During 2001, the Company relied on the services of temporary staff to maintain its collection and data entry departments. Through the process of renegotiation and the establishment of a national service contract, the Company effectively reduced the costs related to these services during 2002, and expects that future expenses will decline further. During the third quarter of 2002, the Company has also initiated an automated process of receiving borrower credit applications electronically, which will further reduce staffing requirements in the Company's data entry department. Total fees for temporary services for the three and nine-month period ended September 30, 2002 were \$0.4 million and \$1.8 million, compared to \$0.9 million and \$3.2 million for the same periods in 2001.

System and servicing expense increased to \$0.8 million for the quarter ended September 30, 2002 from \$0.5 million for the quarter ended September 30, 2001. The increase is principally due to charges in connection with billing and correspondence fees from the Company's outside service provider. During the quarter, the Company elected to transfer a significant portion of its customer correspondence to its outside service provider as a means to increase efficiency and consistency. For the nine-month period ended September 30, 2002, system and servicing charges decreased by \$1.4 million. During the first half of 2001, the Company used the loan accounting and collection system of an external service provider. The charges associated with this provider were directly correlated to the number of Contracts serviced by the Company. As of July 1, 2001, the Company successfully converted to an in-house system and shortly thereafter terminated its agreement with the external provider.

Telephone and data line expenses decreased to \$1.1 million and \$2.5 million for the three and nine-month period ended September 30, 2002, compared to \$1.2 million and \$3.7 million for the same periods in 2001. The significant decrease for the nine-month period was principally due to renegotiated contracts with the Company's data and voice carriers during the year. Assuming no additional reduction in both local and long distance rates, the Company expects these charges to increase relative to the growth of the serviced portfolio.

Depreciation expense decreased to \$0.8 million and \$2.7 million for the three and nine-month period ended September 30, 2002, compared to \$1.1 million and \$3.6 million for the same periods in 2001. Most system upgrades and leasehold improvements associated with the Company's relocation to Foothill Ranch during 1999, and have been fully depreciated. Other operating expenses decreased by \$1.4 million for the quarter and \$1.5 million for the nine-month period ended September 30, 2002, compared to the same periods in 2001. Other operating expenses include professional fees, marketing, supplies, facility related charges, collection expenses, insurance fees and credit bureau fees. Significant reductions were realized in professional related fees during the quarter and nine-month period. Professional fees decreased by \$0.3 million and \$1.4 million for the quarter and nine-month period ended September 30, 2002, compared to the same periods in 2001. The decrease is principally due to the general improvement of the serviced portfolio.

**Table of Contents****Income Taxes**

The Company files federal and certain state tax returns as a consolidated group. Tax liabilities from the consolidated returns are allocated in accordance with a tax sharing agreement based on the relative income or loss of each entity on a stand-alone basis. The effective tax rate for the quarter ended September 30, 2002 was 41.5%. For the quarter ended September 30, 2001, the effective tax rate was 40.1%.

**Financial Condition****Contracts Held for Sale**

Contracts held for sale totaled \$213.6 million at September 30, 2002, compared to \$189.3 million at December 31, 2001. The balance in the held for sale portfolio is largely dependent upon the timing of the origination and securitization of Contracts. The Company completed a securitization transaction of \$450.0 million during the third quarter of 2002. The Company plans to continue to securitize Contracts on a regular basis.

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

**Selected Quarterly Financial Information**

	For the Quarters Ended				
	Sept. 30, 2002	June 30, 2002	Mar. 31, 2002	Dec. 31, 2001	Sept. 30, 2001
	(Restated)				
	(DOLLARS IN THOUSANDS)				
Contracts purchased during period	\$ 403,199	\$ 442,919	\$ 378,180	\$ 365,270	\$ 430,940
Average monthly volume during period	134,399	147,640	126,060	121,757	143,646
Gain on sale of Contracts, net (1)	3,255	2,382	4,295	4,598	6,591
Contracts securitized during period	450,000	400,000	375,000	400,000	400,000
Servicing portfolio at period end	2,902,674	2,895,511	2,848,022	2,864,338	2,876,986

(1) Gain on sale of Contracts includes the gains recorded in connection with the net interest margin securitization executed during the second quarter of 2002, and impairment charges.

**Contracts Held for Investment**

Contracts held for investment are net of a \$1.9 million allowance for future losses for September 30, 2002 and a \$1.3 million allowance for December 31, 2001. Amounts held for investment include Contracts that do not qualify for Contract securitizations as a result of delinquency status or minimum balance.

**Asset Quality**

The Company monitors and attempts to minimize delinquencies and losses through timely collections and the use of predictive dialing and other systems. Annualized net charge-offs as a percentage of the average serviced portfolio were 2.53% and 2.88% for the quarter and nine-month period ended September 30, 2002, compared to 2.64% and 2.66% for the same periods in 2001. At September 30, 2002, thirty plus day delinquencies represented 2.26% of the amount of Contracts in its serviced portfolio compared to 4.01% at December 31, 2001. The reduction in delinquency and charge-offs for the quarter is principally due to the Company's efforts to improve borrower credit statistics, and, to a lesser extent, to seasonal fluctuations. The increase in charge-offs for the nine-month period of 2002 is principally due to higher delinquency rates experienced during the fourth quarter of 2001. Off balance sheet reserves at September 30, 2002 were 4.0%, compared to 4.2% at December 31, 2001. Off balance sheet reserves are those reserves established and maintained on Contracts sold to the owner trusts in connection with securitizations.





**Table of Contents****Delinquency Experience of Serviced Portfolio**

	September 30, 2002		December 31, 2001	
	Amount	No.	Amount	No.
(Dollars in thousands)				
Serviced portfolio	\$2,902,674	291,908	\$2,864,338	289,426
Delinquencies(1)(2)				
30 - 59 days	\$ 46,528	6,022	\$ 78,056	8,918
60 - 89 days	10,545	1,447	20,859	2,456
90+ days	8,549	1,406	15,887	2,023
Total	\$ 65,622	8,875	\$ 114,802	13,397
Total delinquencies as a percent of Serviced portfolio	2.26%	3.04%	4.01%	4.63%

(1) Delinquencies include principal amounts only, net of repossessed inventory and accounts in bankruptcy. Delinquent thirty-plus day repossessed inventory as a percent of the serviced portfolio was 0.53% and 0.77% at September 30, 2002 and December 31, 2001, respectively. Delinquent thirty-plus day Contracts in bankruptcy as a percent of the serviced portfolio were 1.04% and 1.09% at September 30, 2002 and December 31, 2001, respectively.

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

**Loan Loss Experience of Servicing Portfolio**

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2002	2001	2002	2001
(Dollars in thousands)				
Period end Contracts outstanding	\$2,902,674	\$2,876,986	\$2,902,674	\$2,876,986
Average servicing portfolio(1)	\$2,902,140	\$2,850,260	\$2,877,018	\$2,801,049
Number of gross charge-offs	3,201	3,197	10,039	9,813
Gross charge-offs	\$ 21,620	\$ 22,100	\$ 76,499	\$ 65,329
Net charge-offs(2)	\$ 18,343	\$ 18,835	\$ 62,223	\$ 55,950
Annualized net charge-offs as a percent of average Servicing portfolio	2.53%	2.64%	2.88%	2.66%

(1) Average is based on daily balances.

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

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The following table illustrates the monthly cumulative loss performance of each of the securitized pools outstanding for the period from the date of securitization through September 30, 2002:

MONTH	98-B	98-C	99-A	99-B	99-C	99-D	00-A	00-B	00-C	00-D	01-A	01-B	01-C	01-D	02-A	02-B	02-C
1	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2	0.00%	0.02%	0.00%	0.00%	0.01%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
3	0.02%	0.02%	0.02%	0.03%	0.03%	0.01%	0.02%	0.02%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%	0.01%	0.00%	0.00%
4	0.08%	0.04%	0.05%	0.07%	0.06%	0.04%	0.04%	0.04%	0.03%	0.02%	0.02%	0.03%	0.02%	0.02%	0.01%	0.01%	
5	0.19%	0.15%	0.11%	0.14%	0.16%	0.09%	0.11%	0.10%	0.06%	0.07%	0.07%	0.10%	0.05%	0.04%	0.02%	0.04%	
6	0.33%	0.27%	0.21%	0.27%	0.28%	0.15%	0.18%	0.17%	0.11%	0.15%	0.12%	0.18%	0.11%	0.08%	0.07%	0.10%	
7	0.45%	0.46%	0.35%	0.43%	0.47%	0.24%	0.37%	0.30%	0.26%	0.26%	0.20%	0.30%	0.18%	0.14%	0.12%		
8	0.61%	0.57%	0.49%	0.60%	0.64%	0.43%	0.63%	0.44%	0.41%	0.39%	0.31%	0.39%	0.29%	0.22%	0.19%		
9	0.82%	0.74%	0.63%	0.85%	0.83%	0.59%	0.87%	0.67%	0.65%	0.50%	0.47%	0.50%	0.38%	0.32%	0.26%		
10	0.95%	0.94%	0.81%	1.07%	1.09%	0.76%	1.05%	0.90%	0.85%	0.65%	0.60%	0.65%	0.48%	0.44%			
11	1.10%	1.12%	1.04%	1.34%	1.31%	0.99%	1.27%	1.11%	1.08%	0.85%	0.77%	0.77%	0.59%	0.51%			
12	1.20%	1.30%	1.29%	1.56%	1.47%	1.20%	1.59%	1.38%	1.29%	1.03%	0.95%	0.89%	0.70%	0.59%			
13	1.36%	1.54%	1.49%	1.79%	1.62%	1.41%	1.82%	1.57%	1.42%	1.25%	1.14%	1.04%	0.78%				
14	1.48%	1.73%	1.72%	1.90%	1.77%	1.52%	2.03%	1.84%	1.65%	1.41%	1.31%	1.19%	0.89%				
15	1.64%	1.90%	1.90%	2.08%	2.00%	1.70%	2.25%	2.08%	1.93%	1.62%	1.47%	1.33%	1.00%				
16	1.89%	2.10%	2.10%	2.23%	2.08%	2.00%	2.48%	2.26%	2.16%	1.86%	1.64%	1.43%					
17	2.05%	2.28%	2.26%	2.42%	2.29%	2.17%	2.64%	2.42%	2.42%	2.04%	1.78%	1.55%					
18	2.22%	2.51%	2.46%	2.63%	2.48%	2.40%	2.80%	2.69%	2.65%	2.20%	1.96%						
19	2.37%	2.71%	2.59%	2.71%	2.61%	2.61%	2.98%	2.96%	2.97%	2.41%	2.10%						
20	2.50%	2.83%	2.71%	2.89%	2.73%	2.87%	3.25%	3.20%	3.25%	2.60%	2.25%						
21	2.67%	2.95%	2.83%	3.08%	2.92%	3.05%	3.52%	3.44%	3.48%	2.75%							
22	2.79%	3.08%	2.88%	3.21%	3.07%	3.20%	3.69%	3.69%	3.70%	2.92%							
23	2.92%	3.25%	3.03%	3.31%	3.22%	3.33%	3.91%	3.94%	3.95%	3.03%							
24	3.06%	3.39%	3.21%	3.43%	3.32%	3.53%	4.12%	4.18%	4.18%								
25	3.14%	3.45%	3.28%	3.55%	3.43%	3.70%	4.32%	4.39%	4.37%								
26	3.23%	3.57%	3.34%	3.67%	3.65%	3.88%	4.52%	4.57%	4.54%								
27	3.28%	3.72%	3.47%	3.77%	3.79%	4.03%	4.71%	4.74%	4.74%								
28	3.35%	3.81%	3.61%	3.88%	3.90%	4.22%	4.87%	4.91%									
29	3.45%	3.91%	3.67%	4.01%	4.03%	4.42%	5.04%	5.07%									
30	3.50%	4.05%	3.78%	4.14%	4.19%	4.58%	5.23%	5.22%									
31	3.57%	4.13%	3.85%	4.25%	4.28%	4.71%	5.35%										
32	3.67%	4.21%	3.96%	4.37%	4.43%	4.84%	5.48%										
33	3.73%	4.27%	4.07%	4.49%	4.60%	4.98%											
34	3.81%	4.33%	4.18%	4.55%	4.71%	5.11%											
35	3.86%	4.42%	4.25%	4.66%	4.83%	5.21%											
36	3.91%	4.46%	4.32%	4.79%	4.95%	5.32%											
37	4.00%	4.55%	4.37%	4.86%	5.00%												
38	4.04%	4.63%	4.44%	4.94%	5.07%												
39	4.08%	4.73%	4.51%	5.00%													
40	4.13%	4.76%	4.56%	5.05%													
41	4.18%	4.80%	4.66%	5.12%													
42	4.21%	4.87%	4.69%														
43	4.23%	4.94%	4.72%														
44	4.25%	5.00%	4.77%														

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**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 will provide the needed capital to fund Contract purchases, investments in origination and servicing capabilities, and ongoing operations.

The Company's primary source of funds from continuing operations is securitization proceeds. The Company uses the cash generated from securitizations to pay down outstanding commercial paper obligations. These facilities are then used to fund the purchase of Contracts or to finance normal operating expenses. The Company has historically operated on a negative cash flow basis from operating activities. Cash used in operating activities was \$9.0 million for the nine months ended September 30, 2002, compared to \$44.6 million during the same period in 2001. The change in cash used in operating activities for the nine months ended September 30, 2002 versus 2001 is principally due to the relative size of the securitizations executed in comparison to the total volume of Contracts originated during the same time period. For the nine-month period ended September 30, 2002, the Company securitized approximately \$1.23 billion in Contracts and originated approximately \$1.22 billion during the same period. During the nine months ended September 30, 2001, the Company securitized \$1.20 billion in Contracts and originated approximately \$1.24 billion in Contracts. During 2001, net yield credit triggers on five of the Company's outstanding securitizations were hit, restricting future cash releases from the corresponding spread accounts. As a result, the minimum spread account balances were increased, and any subsequent spread releases were first used to reduce the outstanding reinsurance balance.

The Company continued to focus its efforts on building and maintaining its dealer relations through its existing branch locations and did not open any branches during the quarter. Management is currently reviewing market conditions in both Ohio and New York. Capital acquisitions of \$998 thousand during the nine months ending September of 2002 were due to the ongoing maintenance and upgrade of the Company's servicing infrastructure, while acquisitions during 2001 were principally due to the initial charges related to the conversion and installation of the Company's in-house loan accounting and collection system.

*CP Facility:* As of September 30, 2002, the Company was party to a \$355 million warehousing facility (the CP Facility), with Triple-A One Funding Corporation (Triple-A). Onyx Acceptance Financial Corporation (Finco), a special purpose subsidiary of the Company, is the borrower under the CP Facility. The CP Facility is used to fund the purchase or origination of Contracts. Triple-A is a rated commercial paper asset-backed conduit sponsored by MBIA Insurance Corporation (MBIA). MBIA provides credit enhancement for the facility by issuing a financial guarantee insurance policy covering all principal and interest obligations owed for the borrowings under the facility. The Company pledges its Contracts held for sale to borrow from Triple-A. The CP Facility was renewed in November 2001 for a three-year term, subject to annual renewals by liquidity providers.

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*The Residual Lines:* The Company, through Onyx Acceptance Funding Corporation ( Fundco ), currently has two residual financing facilities: a \$50.0 million line with Salomon Smith Barney Realty Corporation ( SBRC ) and a \$35.0 million facility with Credit Suisse First Boston (Europe) Limited, as buyer ( CSFB-Europe ), and Credit Suisse First Boston Corporation, as agent ( CSFB ). (The SBRC facility together with the CSFB-Europe facility 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. Each loan under the SBRC line matures one year after the date of the loan; the Company expects each loan to be renewed at term. The CSFB-Europe line was renewed in October 2001 for a one-year term.

As an additional source of funds, the Company utilizes residual securitizations to pay down its residual financing facilities to increase the Company's liquidity. During the first quarter of 2000, the Company securitized the residual cash flows from 15 of its then outstanding securitizations. The proceeds of this transaction were used by the Company to pay down two residual financing facilities and pay off another residual financing facility. The Company refinanced this residual securitization in the amount of \$21.0 million during the second quarter of 2002. During the first quarter of 2002, the Company completed its second residual interest securitization for the purpose of providing additional borrowing capacity under its Residual Lines. This transaction generated approximately \$75.0 million in proceeds.

**Subordinated Debt:** As of September 30, 2002, the Company had outstanding approximately \$21.5 million of subordinated debt, \$1.6 million of which is being amortized through February 2003 with a stated interest rate of 9.5%. \$12.0 million of subordinated debt has a stated interest rate of 12.5% and a maturity of June 2006. The remaining balance of \$7.9 million was raised through the Company's renewable unsecured subordinated note program launched during the first quarter of 2002. The weighted average interest rate on the balance outstanding as of September 30, 2002 was 8.94%. The renewable notes have varying maturities ranging from three months to ten years.

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 September 30, 2002.

## **Securitizations**

Off balance sheet arrangements are used in the ordinary course of business. Generally, these transactions are structured as off balance sheet sales of Contracts. One of the most common forms of off balance sheet arrangement is Contract 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 three AAA/Aaa rated publicly underwritten asset-backed securitizations during the first, second and third quarters of 2002 in the amount of \$375 million, \$400 million and \$450 million, respectively. During the first quarter, the Company completed its second residual securitization from the residual cash flows of nine outstanding securitizations. The Company did not record a gain on the transaction, as it was structured as a financing transaction rather than a sale. The transaction was rated by Moody's Investor Service, Inc. as Ba2, with proceeds of approximately \$75.0 million. A spread account equal to one year's interest was structured into the transaction. The proceeds of the residual securitization were used to pay down the Company's Residual Lines with affiliates of its securitization underwriters. Additionally, the Company refinanced its residual securitization from the first quarter of 2000 in the amount of \$21.0 million during the second quarter of 2002. The Company plans to continue to integrate residual securitizations in its business plan as a regular source of liquidity.

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 September 30, 2002, the Company has securitized \$7.95 billion of its Contracts in 29 separate transactions. In each of its securitizations, the Company 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 Facility 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 Fluctuations ).

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 projected next 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.

### **Item 3. *Quantitative and Qualitative Disclosures About Market Risk***

The Company's earnings are affected by changes in interest rates as a result of its dependence upon the issuance of interest-bearing securities and the incurrence of debt to fund its lending activities. Several factors can influence the Company's ability to manage interest rate risk. First, Contracts are purchased at fixed interest rates, while the amounts borrowed under the warehouse credit facilities bear interest at variable rates that are subject to frequent adjustment to reflect prevailing market interest rates. Second, the interest rate demanded by investors in a securitization is a function of prevailing market rates for comparable transactions and the general interest rate environment. Because the Contracts originated by the Company have fixed interest rates, the Company bears the risk of smaller gross interest rate spreads in the event interest rates increase during the period between the date Contracts are purchased and the pricing and completion of securitization transactions.

The Company uses several strategies to minimize interest rate risk, including the utilization of derivative financial instruments, the regular securitization of Contracts and pre-funding of securitization transactions. Pre-funding securitizations is the practice of issuing more asset-backed securities than the amount of Contracts initially sold to the Trust. The proceeds from the pre-funded portion are held in an escrow account until additional Contracts are sold to the Trust in amounts up to the balance of the pre-funded escrow account. In pre-funded securitizations, borrowing costs are locked in with respect to the Contracts subsequently delivered to the Trust. However, the Company incurs an expense in pre-funded securitizations equal to the difference between the money market yields earned on the proceeds held in escrow prior to the subsequent delivery of Contracts and the interest rate paid on the asset-backed securities outstanding.

Derivative financial instruments are utilized to manage the gross interest rate spread on the Company's securitization transactions. The Company sells fixed rate Contracts to the trusts that, in turn, sell fixed rate securities to investors. The fixed rates on securities issued by the trusts are indexed to Swap rates on U.S. Treasury Notes with similar average maturities or various London Interbank Offered Rates ( LIBOR ). The Company periodically executes the sale of forward swap agreements to lock in the indexed rate for specific anticipated securitization transactions. The Company utilizes these derivative financial instruments to modify its net interest sensitivity to levels deemed appropriate by management based on the Company's risk tolerance. All transactions are entered into for purposes other than trading, and are settled quarterly upon pricing of the securitization.



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### **Item 4. Controls and Procedures**

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by SEC Rule 13a-15(b), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the quarter covered by this report. The Company's independent auditors have advised the Company of a matter relating to the Company's internal control structure.

To value its Residual Interests in Securitized Assets (RISA), the Company has developed cash flow models using Lotus 123 spreadsheets. The cash flow estimates provided by these models support the Company's income recognition and impairment calculations. The spreadsheets require updating or other factors underlying the cash flow estimates. A separate model exists for each RISA and each model must be manually updated each reporting period for the various factors impacting cash flow estimates. The models are complex and require manual intervention, both of which are factors that increase the propensity for human error. During the second quarter of 2003, the Company identified instances where errors were made in the estimated cash flows and therefore the RISA valuation computations for the third and fourth quarters of 2002. In addition, the Company revised the method for amortizing loan premium amortization on Contracts acquired in connection with clean up calls exercised on the Company's securitization pools. The manner in which the Company had previously been amortizing loan premium understated the amount of amortization during the quarter ended September 30, 2002.

The absence of adequate information systems and policies/procedures to perform the analysis, valuation and record keeping associated with estimating cash flows and calculating loan premium amortization may result in misstatement of the financial statements and is considered a significant deficiency in the Company's internal control structure.

In response to the weaknesses noted above, management now prepares a detailed analysis of loan premium amortization and factors underlying any significant changes in estimated cash flows for each trust during the current quarter versus the previous quarter's estimate to further double-check the evaluation process.

Subject to and limited by the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level.

Apart from the analysis of cash flows and loan premium amortization described above, there has been no change in the Company's internal control over financial reporting during the Company's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **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.

Management believes that the Company has taken prudent steps to address the litigation risks associated with the Company's business. 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.



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

No matters were submitted during the third quarter of the fiscal year covered by this Quarterly Report on Form 10-Q to a vote of security holders, 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 the negative thereof or other variations thereon or

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comparable terminology. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of their dates. Except as required by law, 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 among others, 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**

### **We Need Substantial Liquidity**

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

- acquire Contracts;
- pay dealer participation;
- pay securitization costs and fund related accounts;
- 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 on an annual basis. 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. See Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.

### **We Depend on Warehouse Financing**

We depend on a warehouse facility with a financial institution to finance the purchase or origination of Contracts pending securitization. See Business Financing and Sale of Contracts. Our business strategy requires that such financing continue to be available during the warehousing period.

Whether the CP Facility continues to be available to us depends on, among other things, whether we maintain a target net yield for the Contracts financed under the CP Facility and comply with certain financial covenants contained in the sale and servicing agreement between us, as seller, and our wholly-owned special purpose finance subsidiary, Finco, 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; and
- earnings before interest, depreciation and taxes coverage ratio.

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We cannot assure you that our CP Facility will be available to us or that it will be available on favorable terms. If we are unable to arrange new warehousing credit facilities or extend our existing credit facility when it expires, 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. (See Management's Discussion and Analysis of Financial Condition and Results of Operations - Securitizations ). We typically use the RISA from each securitization as collateral to borrow cash under our Residual Lines 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 experience higher delinquency and loss ratios than expected, then the amount of money we can borrow under the Residual Lines would be reduced. The reduction in availability under these Residual Lines could materially and adversely affect our operations, financial condition and cash flows. Additionally, we are subject, under the documentation governing the Residual Lines, to certain financial covenants. During the third quarter of 2002, the Company recorded a \$5.5 million write-down of the Company's RISA asset stemming from higher than expected losses and delinquency on several securitizations executed prior to 2001. The Company attributes a portion of the higher losses and delinquency experienced to the general economic slow-down the nation is experiencing.

### **We Depend on Residual Securitizations**

We depend on securitizing future cash flows generated by RISA to pay off balances on our Residual Lines and increase liquidity. If our portfolio of securitized Contracts experience higher delinquency and loss ratios than expected, then the proceeds of a residual securitization could be significantly reduced, and the resulting risk associated with the securities could command a higher yield. The inability to successfully market these residual securitizations could materially and adversely affect our operations, financial condition and cash flows.

### **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. See Management's Discussion and Analysis of Results of Operations and Financial Condition Liquidity and Capital Resources, and Business Financing and Sale of Contracts.

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### **We Depend on Credit Enhancement**

From inception through September 30, 2002, 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 enhancement 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 a financial guarantee insurance policy to reduce our borrowing cost under the CP Facility. 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 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 Facility permits us to select maturities to coincide with the projected end of the warehouse period, 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 significantly 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. In periods of increasing interest rates, our cash flows, results of operations and financial condition could be materially 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 gain 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 Facility, we are not able to borrow against defaulted Contracts.

Our servicing income can also be adversely affected by prepayments 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. Under certain circumstances, we would be required to record an impairment charge through a reduction to gain-on-sale. Further, any impairment of RISA could reduce the amount available to us under our Residual Lines, thus possibly requiring us to pay down amounts outstanding under these facilities or provide additional collateral to cure any borrowing base deficiency.

### **Effects of Terrorist Attacks and Military Response**

The long-term economic impact of the events of September 11, 2001 and the United States' continuing military response, remain uncertain, but could have a material effect on general economic conditions, consumer confidence, and market liquidity. No assurance can be given as to the effect of these events on consumer confidence and the performance of the Contracts. Any adverse impact resulting from these events could affect our results of operations, financial condition and cash flows.

In addition, activation of a substantial number of U.S. military reservists or members of the National Guard may significantly increase the proportion of Contracts whose interest rates are reduced by the application of the Soldiers' and Sailors' Civil Relief Act of 1940 (the Relief Act ). The Relief Act provides, generally, that an obligor who is covered by the Relief Act may not be charged interest on the related Contract in excess of 6% annually during the period of the obligor's active duty.

### **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 agreement for the CP Facility;

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

We are entitled to receive servicing income only while we act as servicer under the applicable sale and servicing agreement or pooling and servicing agreement. Under the CP Facility our right to act as servicer can be terminated by our lender or financial insurer, upon the occurrence of certain events.

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### **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;
- the investor rate for securitizations; and
- the marketability and execution of our residual interest securitizations.

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

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. 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 market, 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 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.

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### **We Are Subject to System Risks**

As of July 1, 2001, the Company converted from an external service provider for its loan accounting and collections system to an in-house system. If issues with the in-house system arise in the future, we may be unable to acquire Contracts and service the outstanding portfolio. The failure of this system 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 us to protect the privacy of consumer information;

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**

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 also been named as defendants in an increasing number of class action lawsuits brought by purchasers of motor vehicles and others claiming violation of various federal and state consumer credit, as well as similar and other, laws and regulations.

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 2. *Properties***

The Company did not own any real property at September 30, 2002. The Company's leases approximately 82,000 square feet of office space for its headquarters located in Foothill Ranch, California. The Company also leases office space for its Auto Finance Centers and its Hazelwood, Missouri service center; the average size of an Auto Finance Center is generally four to five thousand square feet. The Hazelwood service center is in approximately 20,000 square feet. One Auto Finance Center is located in the corporate headquarters building.

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**Item 6. Exhibits and Reports of Form 8-K**

(a) Exhibits

Exhibit Number	Exhibit Title
10.128	Form of Sale and Servicing Agreement between Onyx Acceptance Owner Trust 2002-C, Onyx Acceptance Financial Corporation, Onyx Acceptance Corporation and JP Morgan Chase Bank, in connection with the Onyx Acceptance Owner Trust 2002-C*
21.1	Subsidiaries of the Registrant.**
31	Certification pursuant to section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Incorporated by reference from Onyx Acceptance Financial Corporation's Current Report on Form 8-K filed August 1, 2002 (File No. 333-28893).

\*\* Previously filed.

(b) Reports on Form 8-K

None.





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