

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended **June 30, 2010**

or

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

For the transition period from _____ to _____

Commission File Numbers: Not Applicable

DriveTime Automotive Group, Inc.

(Exact name of registrant as specified in its charter)

DELAWARE
*(State or other jurisdiction of
Incorporation or organization)*

86-0721358
*(I.R.S. Employer
Identification No.)*

DT Acceptance Corporation

(Exact name of registrant as specified in its charter)

ARIZONA
*(State or other jurisdiction of
Incorporation or organization)*

82-0587346
*(I.R.S. Employer
Identification No.)*

**4020 East Indian School Road
Phoenix, Arizona 85018**
(Address, including zip code, of principal executive offices)

(602) 852-6600
(Registrants' telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The total number of shares of common stock outstanding as of June 30, 2010, was 200.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

DRIVETIME AUTOMOTIVE GROUP, INC. AND SUBSIDIARIES AND DT ACCEPTANCE CORPORATION AND SUBSIDIARIES Consolidated Balance Sheets

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
	(Unaudited)	
ASSETS		
Cash and Cash Equivalents.....	\$ 24,409	\$ 21,526
Restricted Cash and Investments Held in Trust.....	59,719	84,064
Finance Receivables	1,421,514	1,340,591
Allowance for Credit Losses	(222,000)	(218,259)
Finance Receivables, net	1,199,514	1,122,332
Inventory.....	98,950	115,257
Property and Equipment, net	52,806	51,374
Other Assets.....	46,670	37,527
Total Assets	<u>\$ 1,482,068</u>	<u>\$ 1,432,080</u>
LIABILITIES & SHAREHOLDER'S EQUITY		
Liabilities:		
Accounts Payable	\$ 10,975	\$ 5,060
Accrued Expenses and Other Liabilities	58,824	42,327
Accrued Expenses-Related Party.....	2,728	4,333
Portfolio Term Financings	526,093	795,857
Portfolio Warehouse Facilities.....	203,902	77,506
Senior Secured Notes Payable	161,146	—
Senior Secured Notes Payable-Related Party	36,579	—
Other Secured Notes Payable	55,597	75,277
Other Secured Notes Payable-Related Party.....	—	62,088
Senior Unsecured Notes Payable.....	1,495	1,487
Subordinated Notes Payable-Related Party	—	75,000
Total Liabilities.....	<u>1,057,339</u>	<u>1,138,935</u>
Shareholder's Equity:		
Common Stock	—	—
Paid-in Capital	232,328	131,349
Retained Earnings.....	192,401	161,796
Total Shareholder's Equity.....	<u>424,729</u>	<u>293,145</u>
Total Liabilities & Shareholder's Equity	<u>\$ 1,482,068</u>	<u>\$ 1,432,080</u>

**DRIVETIME AUTOMOTIVE GROUP, INC. AND SUBSIDIARIES
AND DT ACCEPTANCE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations**

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Revenue:				
Sales of Used Vehicles	\$ 178,303	\$ 168,877	\$ 412,923	\$ 393,968
Interest Income	67,444	64,148	129,862	125,802
Total Revenue	<u>245,747</u>	<u>233,025</u>	<u>542,785</u>	<u>519,770</u>
Costs and Expenses:				
Cost of Used Vehicles Sold	114,187	94,313	256,709	219,576
Provision for Credit Losses	34,342	52,302	81,489	122,117
Secured Debt Interest Expense	23,908	22,345	43,623	43,386
Secured Debt Interest Expense-Related party	2,950	1,950	6,663	3,800
Unsecured Debt Interest Expense	35	987	90	3,621
Unsecured Debt Interest Expense - Related party ...	1,605	3,183	3,863	6,341
Selling and Marketing	8,291	7,577	18,221	16,572
General and Administrative	34,008	31,229	65,628	72,925
General and Administrative - Related party	3,233	3,002	6,241	7,181
Depreciation Expense	3,416	3,116	6,853	6,477
Gain on Extinguishment of Debt, net	—	(24,805)	—	(31,559)
Total Costs and Expenses	<u>225,975</u>	<u>195,199</u>	<u>489,380</u>	<u>470,437</u>
Income Before Income Taxes	19,772	37,826	53,405	49,333
Income Tax Expense	450	290	800	660
Net Income	<u>\$ 19,322</u>	<u>\$ 37,536</u>	<u>\$ 52,605</u>	<u>\$ 48,673</u>

See accompanying notes to Condensed Consolidated Financial Statements.

**DRIVETIME AUTOMOTIVE GROUP, INC. AND SUBSIDIARIES
AND DT ACCEPTANCE CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows**

	Six Months Ended June 30,	
	2010	2009
	(\$ in thousands)	
	(Unaudited)	
Cash Flows from Operating Activities:		
Net Income	\$ 52,605	\$ 48,673
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Provision for Credit Losses	81,489	122,117
Depreciation Expense	6,853	6,477
Amortization of Debt Issuance Costs and Debt Premium and Discount	8,329	9,632
Non-Cash Compensation Expense	1,125	1,125
Loss from Disposal of Property and Equipment	263	—
Increase in Finance Receivables	(402,140)	(387,185)
Collections and Recoveries on Finance Receivable Principal	244,456	233,383
Increase (Decrease) in Accrued Interest Receivable and Loan Origination Costs	(987)	899
Decrease in Inventory	16,307	26,764
(Increase) Decrease in Other Assets	(1,181)	9,210
Increase in Accounts Payable, Accrued Expenses and Other Liabilities	19,662	2,871
Decrease in Accrued Expenses-Related Party	(1,605)	(372)
(Decrease) Increase in Income Taxes Payable	(29)	3
Net Cash Provided By Operating Activities	<u>25,147</u>	<u>73,597</u>
Cash Flows from Investing Activities:		
Proceeds from Disposal of Property and Equipment	210	153
Purchase of Property and Equipment	(5,980)	(4,823)
Net Cash Used in Investing Activities	<u>(5,770)</u>	<u>(4,670)</u>
Cash Flows from Financing Activities:		
Increase in Restricted Cash	(3,497)	(3,668)
Deposits into Investments Held in Trust	—	(1,467)
Collections, Buybacks and Change in Investments Held in Trust	27,842	22,128
Additions to Portfolio Warehouse Facilities	385,500	659,512
Repayment of Portfolio Warehouse Facilities	(259,104)	(770,676)
Additions to Portfolio Term Financings	179,047	313,477
Repayment of Portfolio Term Financings	(448,646)	(176,917)
Additions to Other Secured Notes Payable	2,776	18,070
Repayment of Other Secured Notes Payable	(22,456)	(39,084)
Repayment of Senior Unsecured Notes Payable	—	(90,000)
Additions to Senior Secured Notes Payable	161,109	—
Payment of Debt Issuance Costs	(17,065)	(3,710)
Dividend Distributions	(22,000)	—
Net Cash Used In Financing Activities	<u>(16,494)</u>	<u>(72,335)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	2,883	(3,408)
Cash and Cash Equivalents at Beginning of Period	21,526	25,533
Cash and Cash Equivalents at End of Period	<u>\$ 24,409</u>	<u>\$ 22,125</u>

	Six Months Ended June 30,	
	2010	2009
	(\$ in thousands)	
	(Unaudited)	
Supplemental Statement of Cash Flow Information:		
Interest Paid.....	\$ 41,917	\$ 53,252
Interest Paid-Related Party	\$ 11,933	\$ 11,336
Income Taxes (Received) Paid	\$ 829	\$ 657
Supplemental Statement of Non-Cash Investing and Financing Activities:		
Purchase of Property and Equipment Under Capital Lease	\$ 2,778	\$ —
Disposal of Fully Depreciated Property & Equipment	\$ 3,359	\$ 3,580
Exchange of Other Secured Notes Payable to Equity -Related Party	\$ 60,088	\$ —
Exchange of Subordinated Notes Payable to Equity - Related Party	\$ 40,000	\$ —
Exchange of Other Secured Notes Payable-Related Party to Senior Secured Notes Payable.....	\$ 2,000	\$ —
Exchange of Subordinated Notes Payable-Related Party to Senior Secured Notes Payable	\$ 35,000	\$ —
Gain on Extinguishment of Debt, net	\$ —	\$ 31,559

See accompanying notes to Condensed Consolidated Financial Statements.

DRIVETIME AUTOMOTIVE GROUP, INC. AND SUBSIDIARIES
AND DT ACCEPTANCE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of Business, Ownership Formation, Basis of Presentation, and Principles of Consolidation

Description of Business

DriveTime Automotive Group, Inc., (DTAG) and DT Acceptance Corporation (DTAC) (collectively “we,” “our,” and “us”), through wholly-owned subsidiaries, own and operate used automobile dealerships in the United States focusing on the sale and financing of used vehicles to the subprime market. The subprime market is comprised of customers with modest incomes who have experienced credit difficulties or have very limited credit histories. We finance substantially all the vehicles we sell through installment sales contracts (“loans”). We do not sell our loans to third party lenders or finance companies on a servicing released basis and, unlike pure finance companies, we do not purchase finance receivables from other sources. We have historically funded this portfolio primarily through portfolio warehouse facilities and portfolio term financings.

Basis of Presentation

The accompanying consolidated financial statements include the accounts of DTAG and DTAC and their wholly-owned subsidiaries. Also included in the consolidated financial statements are wholly-owned special purpose subsidiaries of DTAC, which are all “bankruptcy remote subsidiaries” formed in conjunction with our securitizations, warehouse facilities and other pooled auto loan program financing transactions.

The financial position and results of operations of DTAG and DTAC are consolidated since these entities are wholly-owned by a principal shareholder, engage in significant intercompany transactions, and provide mutual operational and subordinated financial support. All intercompany accounts and transactions have been eliminated in consolidation for all periods presented and, although not material, certain prior period amounts have been reclassified to be consistent with current period financial statement presentation. The consolidated balance sheets have been adjusted to reflect Mr. Garcia’s basis in the Company through the application of push-down accounting, as it relates to his acquisition of the Company in March 2002 when he acquired our predecessor, Ugly Duckling Corporation.

These consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, such interim consolidated financial statements reflect all normal recurring adjustments considered necessary to present fairly the financial position, results of operations, and cash flows for the interim periods presented. The results of operations for the interim periods are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and footnotes included Offering Memorandum for our 12.625% Senior Secured Notes due 2017, dated May 27, 2010.

Use of Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities. Certain accounting estimates involve significant judgments, assumptions, and estimates by management that have a material impact on the carrying value of certain assets and liabilities, disclosures of contingent assets and liabilities, and the reported amounts of income and expenses during the reporting period which management considers to be critical accounting estimates. The judgments, assumptions, and estimates used by management are based on historical experience, managements’ experience, and other factors, which are believed to be reasonable under the circumstances. Because of the nature of the judgments and assumptions made by management, actual results could differ materially from these judgments and estimates, which could have a material impact on the carrying values of our assets and liabilities and our results of operations.

Significant items subject to estimates and assumptions include the allowance for credit losses, inventory valuation, fair value measurements, certain legal reserves, our reserve for sales returns and allowances, our recovery receivables, and our warranty accrual. Estimates used in deriving these amounts are described in the footnotes herein. Actual results could differ from these estimates.

Relationship with Verde Investments, Inc.

Verde Investments, Inc. (hereinafter referred to as “Verde”) is an Arizona corporation that is wholly-owned by Ernest C. Garcia II, our Chairman and sole shareholder. Verde engages in the acquisition, development, and long-term investment in real estate and other commercial assets. Mr. Garcia is the sole stockholder, president and director of Verde. Transactions between us and Verde are described in Note [7] Related Party Transactions.

(2) Restricted Cash and Investments Held in Trust

We maintain various cash accounts, which are pledged as collateral under our debt agreements. We are permitted to invest funds in these accounts in short-term, high quality liquid investments. The following is a summary of restricted cash and investments held in trust:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
	(Unaudited)	
Restricted cash.....	\$ 30,625	\$ 27,128
Investments Held in Trust.....	29,094	56,936
	\$ 59,719	\$ 84,064

Restricted Cash

Restricted cash consists of collections related to loans held in securitization trusts, loans pledged to our portfolio warehouse facilities, and loans included in Pooled Auto Loan Program (PALP) transactions, which have been collected from customers, but have not yet been submitted either to the lenders or the securitization trustee, as appropriate.

Investments Held in Trust

We maintain cash reserve accounts on behalf of Asset-Backed Security investors in our securitizations and certain PALP transactions as a form of credit enhancement. At the time loans are transferred to a trust, a portion of the proceeds from sales of notes are deposited into a reserve account that is pledged to the trusts. We may be required to make additional deposits to reserve accounts from collections on the loans to fund the reserve account to the required target percentage. Investments held in trust also include collections related to loans held in securitization trusts and loans included in PALP financing transactions, which have been collected from customers, and submitted to the trustee, but have not yet been paid to the lenders, as appropriate. Balances in the reserve accounts (which are a component of investments held in trust) totaled \$14.5 million at June 30, 2010 and \$26.1 million at December 31, 2009.

(3) Finance Receivables

The following is a summary of finance receivables:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
	(Unaudited)	
Principal Balances	\$ 1,392,152	\$ 1,312,216
Accrued Interest.....	11,887	10,806
Loan Origination Costs.....	17,475	17,569
Finance Receivables	<u>\$ 1,421,514</u>	<u>\$ 1,340,591</u>

(4) Allowance for Credit Losses

The following table sets forth the rollforward of the allowance for credit losses for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Allowance Activity:				
Balance, beginning of period	\$ 222,109	\$ 246,100	\$ 218,259	\$ 242,600
Provision for credit losses.....	34,342	52,302	81,489	122,117
Net charge-offs	(34,451)	(53,302)	(77,748)	(119,617)
Balance, end of period	<u>\$ 222,000</u>	<u>\$ 245,100</u>	<u>\$ 222,000</u>	<u>\$ 245,100</u>
Allowance as a percent of ending principal...	15.9%	17.8%	15.9%	17.8%
Charge off Activity:				
Principal balances	\$ (58,434)	\$ (77,714)	\$ (132,462)	\$ (174,417)
Recoveries, net	23,983	24,412	54,714	54,800
Net charge-offs	<u>\$ (34,451)</u>	<u>\$ (53,302)</u>	<u>\$ (77,748)</u>	<u>\$ (119,617)</u>

(5) Debt Obligations

Portfolio Term Financings

The following is a summary of portfolio term financings:

	June 30, 2010	December 31, 2009
	(\$ in thousands)	
	(Unaudited)	
Securitization Debt:		
Asset Backed Security obligations issued pursuant to the Company's securitizations	\$ 175,528	\$ 268,533
Pooled Auto Loan Program Financings:		
Fixed rate secured financing transactions for our finance receivable portfolio	250,565	527,324
Portfolio Term Residual Financing:		
Fixed rate financing facility secured by finance receivables residual interests in warehouse facilities	100,000	—
Total Portfolio Term Financings	<u>\$ 526,093</u>	<u>\$ 795,857</u>

Securitization debt

Asset-backed securities outstanding are secured by underlying pools of finance receivables and investments held in trust of \$294.2 million and \$431.9 million at June 30, 2010 and December 31, 2009, respectively. Asset-backed securities outstanding have interest payable monthly at fixed rates ranging from 5.3% to 5.6% at June 30, 2010 and 5.2% to 5.6% at December 31, 2009. These rates represent the original duration weighted average rates of the outstanding asset-backed securities. Credit enhancement for the asset-backed securities consists of a reserve account, over collateralization, and subordination of the notes in each trust which are subordinate in nature to the securities. Over collateralization represents finance receivable principal balance in excess of the face value of asset-backed securities issued. Cash reserves are funded with proceeds from the sale of asset-backed securities and through cash collections. At June 30, 2010, our 2009-1 and our 2007-A securitization trusts comprise the outstanding balance depicted above. The 2007-A asset-backed securities are wrapped with a financial guaranty insurance policy.

Performance triggers. Our 2007-A securitization trust contains certain covenants, including limitations on delinquencies, periodic net charge-offs, and cumulative net charge-offs (“performance triggers”). If a trust exceeds a performance trigger the required cash reserve increases and cash flow from the loans in the trust is “trapped” until the reserve account reaches the specified level, or until the holders are paid in full or the insurer waives the event. If the trust performance goes below the performance trigger the trapped cash is returned to us. Our 2009-1 trust does not contain these triggers. At June 30, 2010 and December, 31 2009, all trusts were in compliance with their performance triggers and there have been no requirements to trap cash or any termination events.

Individual securitization trusts are not cross-collateralized or cross-defaulted. Additionally, we have the option to purchase the remaining loans in a trust when the remaining principal balances of the loans reach a specified percentage (generally 10%) of their original principal balance.

Pooled auto loan program financings (PALP)

PALP financings are secured by underlying pools of finance receivables and in certain cases a cash reserve account. At June 30, 2010, interest rates on our outstanding PALP facilities range from 8.0% to 8.71%. At June 30, 2010 and December 31, 2009, the aggregate amount of finance receivables and cash reserve accounts securing these financings were \$353.9 million and \$739.3 million, respectively. The net advance rate on the receivables ranged from 68.6% to 74.5% of the principal balance for transactions outstanding at June 30, 2010 and from 67.6% to 73.4% of the principal balance for transactions outstanding at December 31, 2009. In certain cases there may be a cash reserve/holdback which is netted against the debt amount to arrive at the net advance rate.

In May 2010, in conjunction with the execution of Warehouse Facility II with Santander Consumer USA Inc. (Santander), we reduced one of our PALP facilities with Santander, from a \$518.0 million borrowing capacity to a \$250.0 million borrowing capacity.

Portfolio term residual financing

In May 2010, we entered into a \$350.0 million combined warehouse and warehouse residual facility with Santander secured primarily by finance receivables and residual interests in our warehouse facilities. This facility allows for maximum borrowings under a term component of \$100.0 million at an advance rate of 75% on the receivables pledged to the facility and under a revolving component of \$250.0 million at an advance rate of 70%, on the receivables pledged to the facility. The term component provides for funding through April 2012 with a term-out feature resulting in a final maturity of April 2013. Interest on the term component is fixed at 8.62%.

Portfolio warehouse facilities

The following is a summary of portfolio warehouse facilities

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(\$ in thousands)	
	(Unaudited)	
Portfolio Warehouse Facilities:		
Warehouse Facility I - secured by certain finance receivables of the Company	\$ 61,565	\$ 77,506
Warehouse Facility II - secured by certain finance receivables of the Company	100,000	—
Warehouse Facility III - secured by certain finance receivables of the Company.....	42,337	—
Total Portfolio Warehouse Facilities.....	<u>\$ 203,902</u>	<u>\$ 77,506</u>

Warehouse Facility I

As of June 30, 2010, this facility with Deutsche Bank AG, New York Branch (Deutsche Bank), which expires in December 2010, has total capacity of \$250.0 million, and amounts outstanding at June 30, 2010 are secured by finance receivable principal balances of \$113.9 million, carries an advance rate on the receivables pledged to the facility of 58%, and amounts outstanding under the facility bear interest based on the lenders' cost of funds there-under plus 4.25% (4.66% at June 30, 2010). This facility also has a term-out feature resulting in a final maturity of December 2011. At June 30, 2010, we were in compliance with all financial covenants of this facility.

In July 2010, we amended this facility. See Note 12 – Subsequent Events for more information.

Warehouse Facility II

In May 2010, we entered into a portfolio warehouse facility agreement with Santander with a capacity of \$250.0 million. This facility is secured by finance receivables of \$189.5 million at June 30, 2010, carries an advance rate on the receivables pledged to the facility of 70%, and amounts outstanding under the facility bear interest at LIBOR plus 5.00% (5.35% at June 30, 2010) on the first \$100.0 million outstanding and LIBOR plus 4.25% for amounts outstanding in excess of \$100.0 million. This agreement requires us to maintain \$100.0 million outstanding at all times. This revolving facility provides for funding through April 2011 with a term-out feature resulting in a final maturity of May 2012. At June 30, 2010, we were in compliance with all financial covenants of this facility.

Warehouse Facility III

In April 2010 we entered into a portfolio warehouse facility agreement with UBS Real Estate Securities Inc. (UBS) with a capacity of \$125.0 million. This facility is secured by finance receivables of \$103.0 million at June 30, 2010, carries an advance rate on the receivables pledged to the facility of 50%, and amounts outstanding under the facility bear interest at LIBOR plus 2.50% (2.85% at June 30, 2010). This revolving facility provides for funding through April 2011 with a term-out feature resulting in a final maturity of April 2012. At June 30, 2010 we were in compliance with all financial covenants of this facility.

We formed individual LLC's, each of which is a wholly-owned subsidiary of DTAC, which serve as the sole borrowers under our existing portfolio warehouse facilities. Each of these LLC's is a special purpose entity established specifically for the purpose of the applicable lending relationship, with assets and liabilities distinct from the remainder of the DriveTime group. These facilities do not contain mark-to-market clauses that would otherwise enable the lenders to reduce advance rates based on market conditions, have recourse limited to 10.0% of the respective facility amounts, and limit the lenders' ability to sell or otherwise dispose of the underlying collateral in the event of default. In addition, on the termination date of the facilities, (i) amounts outstanding at termination are not due and payable immediately, (ii) all collections on the contracts collateralizing these facilities would be used to pay down the facility until they are paid in full, and (iii) we would continue to service the contracts that are pledged under this facility, for which we would receive an annualized service fee of up to 7.0%.

Each of these LLC's for Warehouse facility I, II and III, have entered into demand notes in the amounts of \$25.0 million, \$35.0 million, and \$12.5 million, respectively, with DTAC, each of which has been assigned to the applicable lender. Each demand note is guaranteed by DTAG, Ernest C. Garcia II, our Chairman and sole shareholder, and Verde. Prior to the termination date under each of these warehouse facilities, under certain circumstances, the applicable lender can require DTAC to fund the demand note, and apply the proceeds to pay down the facility with the applicable special purpose entity. After the termination date under the applicable lender or program agent can require DTAC to fund the demand note, at its sole discretion, and apply the proceeds to pay down the facility with the applicable special purpose entity if, and only if, any of the following occurs: (i) the Termination Date occurs as a result of an Event of Termination (as defined in each agreement), (ii) the applicable special purpose entity fails to maintain borrowing base compliance after the termination date, (iii) an Event of Termination occurs after the termination date and is continuing and (iv) other than with respect to Warehouse facility II the applicable special purpose entity fails to effect its required clean-up call.

Effective July 2010, we entered into a fourth portfolio warehouse facility agreement with The Royal Bank of Scotland PLC (RBS). See Footnote 12 – Subsequent Events for more information.

Senior secured notes payable

A summary of senior secured notes payable follows:

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(\$ in thousands)	
	(Unaudited)	
Senior Secured Notes Payable, net - interest at 12.625% per annum (Priced to yield 12.875%) interest payable semi-annually, principal balance due June 15, 2017.....	\$ 161,146	\$ —
Senior Secured Notes Payable, net – Related Party.....	36,579	—
Total Secured Notes Payable	<u>\$ 197,725</u>	<u>\$ —</u>

In June 2010 we issued \$200.0 million of 12.625% senior secured notes due June 15, 2017. The notes were issued with an original issuance price of 98.854%, resulting in an effective yield of 12.875%. Simultaneously with this offering, Verde exchanged \$35.0 million of our subordinated notes and our President and Chief Executive Officer (Ray Fidel) exchanged \$2.0 million of our junior secured notes for \$37.0 million aggregate principal balance of senior secured notes issued. Therefore, net proceeds to the Company, after fees, expenses and issuance of the \$37.0 million to related parties, were approximately \$155.9 million. Interest on the notes is payable semi-annually in arrears on each June 15 and December 15. At June 30, 2010 the notes are shown net of unamortized discount of \$2.3 million.

Guarantees

The notes are unconditionally guaranteed on a senior secured basis by certain of our existing and future domestic restricted subsidiaries. The guarantees rank senior in right of payment to all existing and future subordinated indebtedness of these subsidiaries and equal in right of payment with all existing and future senior indebtedness of these subsidiaries.

Security

The notes and the guarantees have (i) a first priority lien on certain finance receivables, on residual property rights with respect to finance receivables securing other financings, and on residual equity interests in certain special purpose financing subsidiaries of the Issuers and (ii) a second priority lien on automobiles and other vehicles held as inventory.

Maintenance covenants

We are required to comply with certain maintenance covenants relating to minimum net worth and minimum collateral coverage. As of June 30, 2010 we are in compliance with such covenants.

Exchange offer; registration rights

We have agreed to file a registration statement with the Securities and Exchange Commission (the “SEC”) and to make an offer to exchange the notes for registered, publicly tradable notes that have substantially identical terms as the notes. However, we do not intend to apply for listing of the notes on any securities exchange. To date, the registration statement has not been filed and the exchange notes are not effective. We have until October 4, 2010 to file our registration statement with the SEC without being required to make additional interest payments on the notes and until December 31, 2010 to effect the registration statement without being required to make additional interest payments on the notes.

Other secured notes payable

A summary of other secured notes payable follows:

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(\$ in thousands)	
	(Unaudited)	
Revolving Inventory Facility, secured by the Company's vehicle inventory	\$ 40,000	\$ 50,000
Junior Secured Notes due December 2012, secured by Finance Receivables-Related Party	—	62,088
Repurchase Facility - Secured by 2009-1 Securitization Bonds owned by the Company	—	12,231
Mortgage Note Payable Bearing Interest at 5.87% due March 2017, secured by real property	12,953	13,046
Equipment Note Payable due April 15, 2013, secured by an aircraft.....	2,644	—
Total Other Secured Notes Payable	\$ 55,597	\$ 137,365

Revolving inventory facility

At June 30, 2010, the revolving inventory facility has a maximum capacity of \$50.0 million, a maturity date of August 2010, an interest rate of LIBOR plus 6.0% (6.35% at June 30, 2010) and is secured by \$73.6 million of vehicle inventory. In May 2010, we amended this facility to reduce its capacity from \$60.0 million to \$50.0 million; no other terms were adjusted. At June 30, 2010 we were in compliance with all financial covenants of this facility.

Junior secured notes – related party

At December 31, 2009, these notes consisted of a \$38.1 million Tranche A component and a \$24.0 million subordinate Tranche B component and had a maturity of December 2012. These notes were secured by a junior interest in our finance receivables. The Tranche A component was comprised of four notes, three of which were payable to Verde in the aggregate amount of \$36.1 million and one of which was a \$2.0 million note to Mr. Fidel, our Chief Executive Officer) and the Tranche B component was comprised of one subordinate note to Verde.

In conjunction with our offering of our \$200.0 million 12.625% senior secured notes due 2017 issued in June 2010, Verde agreed to transfer to our sole shareholder and our sole shareholder agreed to receive and contribute to equity, the aggregate amount of the Tranche A and B junior secured notes in the amount of \$60.1 million. In conjunction with this exchange these notes were cancelled. In addition, the \$2.0 million Tranche A note held by Mr. Fidel was exchanged (and contemporaneously cancelled) for an equal principal amount of the 12.625% senior secured notes due 2017. As a result of these transactions, our obligations under the junior secured notes have been satisfied.

See Note 7—Related Party Transactions for more information regarding transactions involving the Junior Secured Notes and Verde.

Repurchase facility

In December 2009, we issued \$192.6 million of securitization bonds in conjunction with our 2009-1 securitization. We purchased \$17.5 million of the initial issuance. This purchase was funded with cash and \$12.2 million in borrowings under a 30-day rolling repurchase facility with interest at LIBOR plus 1.5%.

In connection with our \$200.0 million 12.625% senior secured notes offering in June 2010, we utilized a portion of the proceeds to repay the amount then outstanding on this facility and this facility is now terminated.

Mortgage note payable

Our mortgage note payable is secured by our operations call center building in Mesa, Arizona (a commercial property). Terms of the note agreement provide for monthly principal and interest payments with a balloon payment due in March 2017. At June 30, 2010, we were in compliance with all financial covenants of this loan.

Equipment note payable

In April 2010 we entered into a three year term loan with an original principal amount of \$2.7 million bearing interest at the Prime rate plus 1.5% (4.75% at June 30, 2010). Terms of the note agreement provide for monthly principal and interest payments with a balloon payment due in April 2013. At June 30, 2010, we were in compliance with all financial covenants of this loan.

Unsecured notes payable

A summary of senior unsecured notes payable follows:

	<u>June 30,</u> <u>2010</u>	<u>December 31,</u> <u>2009</u>
	(\$ in thousands)	
	(Unaudited)	
Senior Unsecured Notes Payable, net—Interest at 11.25% per Annum (Priced to Yield 12.5%) Payable Semi-Annually, Principal Balance Due October 1, 2010 ..	\$ 1,495	\$ 1,487
Subordinated Notes—Related Party	—	75,000
Total Unsecured Notes Payable	<u>\$ 1,495</u>	<u>\$ 76,487</u>

The senior unsecured notes due 2010 are shown net of unamortized discount of \$4,500 and \$13,000 at June 30, 2010, and December 31, 2009, respectively. At June 30, 2010, we were in compliance with all required covenants of these notes.

During 2008, Verde provided a total of \$75.0 million in cash to us in return for subordinated notes payable. At December 31, 2009, these notes bore interest at 12.0% and had a maturity of August 2013. In conjunction with our offering of our \$200.0 million 12.625% senior secured notes due 2017 issued in June 2010, Verde agreed to transfer to our sole shareholder and our sole shareholder agreed to receive and contribute to equity, \$40.0 million of such subordinated notes, at which time the notes were cancelled. In addition, the remaining \$35.0 million in subordinated notes payable to Verde were exchanged (and contemporaneously cancelled) for an equal principal amount of senior secured notes due 2017. As a result of these transactions, our obligations under the subordinated notes payable have been satisfied.

(6) Gain on Extinguishment of Debt

A summary of net gains on extinguishment of debt is as follows:

Six Months Ended June 30, 2009			
Month	Type	Principal Repurchased (\$ in thousands) (Unaudited)	Net Gain (Loss)
January.....	Senior Unsecured Notes	\$ 15,000	\$ 4,908
March.....	2007-A Securitization Debt	13,200	1,846
April.....	Senior Unsecured Notes	30,000	9,911
May.....	Senior Unsecured Notes	25,000	8,246
June.....	Senior Unsecured Notes	20,000	6,648
			\$ 31,559

(7) Related Party Transactions

During the three and six months ended June 30, 2010 and 2009, we recorded related party operating expenses as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
(\$ in thousands) (Unaudited)				
General and Administrative Expenses - Related Party				
Property lease expense	\$ 1,190	\$ 1,195	\$ 2,271	\$ 2,422
Store closing costs.....	624	227	890	1,698
Non-cash compensation expense.....	562	562	1,125	1,125
Aircraft lease expense	489	487	976	974
Aircraft operating expense	348	446	794	773
Salaries and wages, general & administrative and other expenses...	178	138	395	294
Reimbursement of certain general and administrative expenses.....	(158)	(53)	(210)	(105)
Total General and Administrative Expenses - Related Party	\$ 3,233	\$ 3,002	\$ 6,241	\$ 7,181

Property lease expense—related party

For the three and six months ended June 30, 2010, we leased an average of 16 vehicle sales facilities, three reconditioning centers, our former loan servicing center (which is currently being partially subleased to a third-party tenant), and our corporate office from Verde and another affiliate of Mr. Garcia (the Garcia Family Limited Liability Partnership, LLP). At June 30, 2010, three of these facilities are closed locations. For the three and six months ended June 30, 2010, we also leased one used vehicle sales facility and a reconditioning center, which are both closed locations, from a director and officer of DTAC, Steven Johnson, who is also Mr. Garcia's brother-in-law. At June 30, 2010, the maturity of these leases ranges from 2013 to 2023. During the three months ended June 30, 2010, we paid \$0.4 million in a lease termination fee on one of our closed properties to terminate the lease with Verde. This amount was previously accrued and did not have an impact on net income.

For the three and six months ended June 30, 2009, we leased an average of 18 vehicle sales facilities, three reconditioning centers, our former loan servicing center (which was being subleased to two third-party tenants), and our corporate office from Verde and another affiliate of Mr. Garcia (the Garcia Family Limited Liability Partnership, LLP). At June 30, 2009, five of these facilities are closed locations. For the three and six months ended June 30, 2009, we also leased two and one, respectively, used vehicle sales facilities and a reconditioning center from Steven Johnson. The facilities we lease from Mr. Johnson are closed locations.

Store closing costs on related party leases

During the years ended December 31, 2008 and 2009, we closed a total of 28 dealerships and six reconditioning centers, 10 of which were facilities we lease from Verde and Steven Johnson. These facilities are a subset of the leases described above in Property Lease Expense. In accordance with ASC 420—Exit or Disposal Activities (ASC 420), we recorded lease obligations, asset disposal costs, and other closing costs associated with these closures for the periods presented. We remain obligated for related party leases on three and four dealership facilities as of June 30, 2010 and December 31, 2009, respectively. We also remain obligated on two closed reconditioning centers and one closed operations facility as of June 30, 2010 and December 31, 2009. We ceased use of a former loan servicing center in 2007 and this facility is currently being subleased. The store closing costs represent ongoing costs related to property leases, property taxes, and maintenance, which are reflected in our general and administrative expenses – related party.

As of both June 30, 2010 and December 31, 2009, \$2.3 million remains in accrued expenses and other liabilities – related party on the accompanying consolidated balances sheets for these lease obligations. The expiration of these leases range from 2013 to 2018.

Non-cash compensation expense

See Note 9 – Shareholder’s Equity & Dividends for details.

Aircraft lease and operating expenses

In September, 2005, we entered into a lease with Verde for an aircraft. Under the terms of the lease agreement, we agreed to pay monthly lease payments of \$150,000 plus taxes to Verde, and are responsible for paying all costs and expenses related to the aircraft and its operations. The lease term expires September 2010.

Salaries and wages, general and administrative and other expenses

Certain general and administrative expenses and salaries and wages of Verde and Verde employees who are enrolled in our health plan are reflected in our general and administrative expenses—related party.

Reimbursement of general and administrative expenses

For each of the periods presented, we received reimbursement of certain general and administrative expenses (discussed above) incurred by us on Verde’s behalf. This amount was \$52,500 for each of the quarters in 2009, and was \$105,000 for each of the quarters in 2010.

During the three and six months ended June 30, 2010 and 2009, we recorded related party interest expense as follows:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Secured Debt Interest Expense - Related Party				
Junior Secured Notes:				
Tranche A - Related Party: CEO.....	\$ 77	\$ 99	\$ 185	\$ 198
Tranche A - Related Party: Verde.....	1,389	351	3,374	602
Tranche B - Related Party: Verde.....	1,134	1,500	2,754	3,000
Senior Secured Notes:				
\$35.0 million Senior Secured Notes Payable – Verde.....	331	—	331	—
\$2.0 million Senior Secured Notes Payable – CEO.....	19	—	19	—
Total Secured Debt Interest Expense - Related Party	\$ 2,950	\$ 1,950	\$ 6,663	\$ 3,800

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Unsecured Debt Interest Expense - Related Party				
\$32.0 million Senior Unsecured Notes Payable.....	—	900	—	1,800
\$75.0 million Subordinated Notes Payable.....	1,605	2,283	3,863	4,541
Total Unsecured Debt Interest Expense - Related Party	\$ 1,605	\$ 3,183	\$ 3,863	\$ 6,341

Secured debt interest expense—related party

In December 2008, we issued junior secured notes. These notes consisted of a Tranche A component and a subordinate Tranche B component. The Tranche A component was comprised of four notes (one of which is a \$2.0 million note to Mr. Fidel, our Chief Executive Officer) and the Tranche B component was comprised of one subordinate note to Verde. At December 31, 2009, the Tranche A notes bore interest at 22.0% per annum, increasing by 2.0% each year until maturity and the Tranche B notes bore interest at 27.0% per annum, increasing 2.0% each year until maturity.

During the year ended December 31, 2009, Verde purchased an aggregate amount of \$36.1 million in notes from third-party Tranche A note holders. After these transactions at December 31, 2009, Verde held \$36.1 million of Tranche A junior secured notes and the \$24.0 million Tranche B junior secured notes.

In conjunction with our offering of our \$200.0 million 12.625% senior secured notes due 2017, issued in June 2010, Verde agreed to transfer to our sole shareholder and our sole shareholder agreed to receive and contribute to equity, the aggregate amount of the Tranche A and B junior secured notes in the amount of \$60.1 million. In conjunction with this exchange these notes were cancelled. In addition, the \$2.0 million Tranche A note held by Mr. Fidel was exchanged (and contemporaneously cancelled) for an equal principal amount of the 12.625% senior secured notes due 2017. As a result of these transactions, our obligations under the junior secured notes have been satisfied and Verde and our CEO now own \$35.0 million and \$2.0 million, respectively, of our 12.625% senior secured notes due 2017.

Unsecured debt interest expense—related party

During 2008, in two separate transactions, Verde purchased \$32.0 million face value of our 11.25% senior unsecured notes due 2013. These purchases were made on the open market between Verde and a third-party broker. The purchase prices were 70.0% of face value and 52.0% of face value.

In September 2009, we repurchased the \$32.0 million face value of our 11.25% senior unsecured notes from Verde for face value, but incurred a loss on extinguishment of \$1.2 million, related to the write-off of unamortized deferred financing costs. The write-off was not treated as a capital transaction since the costs to issue the senior unsecured notes was incurred in 2005 when the notes were originally issued. In addition, the notes were originally issued 100% to third parties.

In the second quarter of 2008, Verde provided a total of \$75.0 million in cash to us in return for subordinated notes, bearing interest at 12.0% per annum, and with a maturity date of August 2013. In conjunction with the senior secured notes offering in June 2010, Verde agreed to transfer to our sole shareholder and our sole shareholder agreed to receive and contribute to equity, \$40.0 million of subordinated notes payable, at which time the notes were cancelled. In addition, the remaining \$35.0 million in subordinated notes payable to Verde were exchanged (and contemporaneously cancelled) for an equal principal amount of senior secured notes due 2017. As a result, as of June 30, 2010, we are no longer obligated on the \$75.0 million subordinated notes payable.

(8) Income Taxes

The consolidated financial statements consist of DTAG (S-corporation status elected in 2004) and DTAC (an S-corporation since inception). Since DTAC and DTAG are flow through entities for Federal income tax purposes, there is no Federal income tax expense related to the income of DTAC and DTAG, other than for one of DTAG's wholly-owned subsidiaries, which is a C-corporation. The taxable income flows through to our shareholder who is responsible for paying the associated taxes. Although most states follow the Federal recognition of S-corporation status, some states do impose an entity level tax on that income; therefore, the tax expense is adjusted accordingly. Income tax liability was \$1.1 million as of both June 30, 2010 and December 31, 2009.

(9) Shareholder's Equity & Dividends

Certain of our debt facilities place restrictions on the amount of cash dividends we are permitted to pay to our shareholder. We are permitted to pay cash dividends limited to an amount not greater than the percentage of S-corporation taxable income for such quarterly period equal to the highest combined federal, state, and/or local tax rate for individuals, plus 50% of the difference between taxable earnings less amounts paid for tax.

During the six months ended June 30, 2010, we paid \$22.0 million in dividends related to 2010 income. We did not have any approved but unpaid dividends at June 30, 2010 or December 31, 2009, however, we had \$12.7 million available to be distributed. See Note 12 – Subsequent Events for further details.

In January 2008, Mr. Garcia entered into an agreement with Mr. Fidel to purchase Mr. Fidel's 5% interest in DTAG and DTAC for \$17.5 million. The terms of the purchase were such that Mr. Garcia paid Mr. Fidel \$6.25 million in cash and \$11.25 million in a promissory note bearing interest at 8.0% per annum. The term of the note is five years with annual installment payments required. The agreement contains an employment condition, requiring Mr. Fidel to remain employed with the Company through June 30, 2010. In the event Mr. Fidel voluntarily terminated his employment as the President and Chief Executive Officer of the Company at a time prior to June 30, 2010, one-half of the principal balance of the note would be waived and no longer payable by Mr. Garcia. Accordingly, one-half of the \$11.25 million note was deemed compensation expense to be recognized over the term of the employment condition. As a result, \$562,500 and \$1,125,000 of non-cash compensation expense was recorded for the three and six months ended June 30, 2010 and 2009, respectively, as an increase to general and administrative expenses - related party and increase to paid-in capital on the accompanying consolidated statements of operations and balance sheets.

Prior to June 30, 2010, Verde, which is wholly-owned by our sole beneficial shareholder, Mr. Garcia, was the holder of all of our outstanding \$75.0 million 12% subordinated notes and the holder of \$60.1 million of our junior secured notes. In conjunction with our offering of our 12.625% senior secured notes due 2017 issued in June 2010, Verde agreed to transfer to Mr. Garcia and Mr. Garcia agreed to receive and contribute to equity an aggregate of \$100.1 million of debt, comprised of \$40.0 million in subordinated notes and \$60.1 million in junior secured notes. As a result of this agreement, paid-in capital was increased by \$100.1 million in June 2010.

As a result of the exchange of debt for equity by Mr. Garcia, we wrote-off unamortized deferred financing costs associated with the subordinated notes and junior secured notes. The portion of the unamortized costs associated with related party debt and the discount associated with the issuance of the senior secured notes owned by Mr. Garcia were treated as capital transactions and resulted in decreases to paid-in capital of approximately \$0.6 million and \$0.4 million, respectively.

(10) Commitments and Contingencies

Limited warranty

We provide our DriveCare® limited warranty covering major mechanical and air-conditioning coverage, on every vehicle we sell. The warranty is included in the sales price of the vehicle and is not sold as a separate product. A liability for the estimated cost of vehicle repairs under our DriveCare® limited vehicle warranty program is established at the time a used vehicle is sold by charging costs of used vehicles sold. We currently offer no warranty outside of our DriveCare® limited warranty. Vehicles sold prior to December 1, 2009 are covered for six months / 6,000 miles on major mechanical items. Starting with sales in December 2009, we extended our DriveCare® limited

warranty plan from six months / 6,000 miles to 36 months / 36,000 miles, including oil changes at Sears automotive locations nationwide and 24/7 roadside assistance. The liability is evaluated for adequacy through an analysis based on a combination of the program's historical performance of warranty cost incurred per unit sold over the term of the warranty and on actuarial information provided by a third party. The accrual for oil changes is based on 100% utilization of this coverage, since non-use of the oil change could void the customer's warranty.

The limited warranty accrual is recorded as a component of accrued expenses and other liabilities on the accompanying consolidated balance sheets for each year presented. The following table reflects activity in the warranty accrual and accrued oil changes combined, for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Balance, Beginning of Period	\$ 5,271	\$ 1,008	\$ 920	\$ 777
Warranty Expense	4,345	483	9,829	1,424
Warranty Claims Paid	(1,756)	(802)	(2,889)	(1,512)
Balance, End of Period	<u>\$ 7,860</u>	<u>\$ 689</u>	<u>\$ 7,860</u>	<u>\$ 689</u>

Lease commitments

During 2008 and 2009 we closed dealerships and reconditioning centers and incurred store closing costs and recorded lease termination liabilities in accordance with ASC 420—Exit or Disposal Activities (ASC 420). At June 30, 2010, approximately \$2.5 million remains in accrued expenses and other liabilities on the accompanying consolidated balance sheet for these lease obligations. At June 30, 2010, the expiration of these leases range from 2012 to 2018.

Legal matters

We are involved in various claims and actions arising in the ordinary course of business. In the opinion of management, based on consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on us. We believe appropriate accruals have been made for the disposition of these matters. In accordance with Statement of FASB ASC 450, *Contingencies*, we established an accrual for a liability when it is both probable that the liability has been incurred and the amount of the loss can be reasonably estimated. These accruals are reviewed monthly and adjusted to reflect the impact of negotiations, settlements and payments, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Legal expenses related to defense, negotiations, settlements, rulings, and advice of outside legal counsel are expensed as incurred.

In August 2008, we received a Civil Investigative Demand from the Texas Office of Attorney General, Consumer Protection Division, asking for the production of certain materials. The demand indicates it is the subject of an investigation of possible violations of the Deceptive Trade Practices Act, Sections 17.46(a) and (b) in the marketing, advertising, financing, and selling of used cars. We provided the Texas Office of Attorney General with all requested information in August 2008. At that time, we met with the state's Attorney General's Office to provide them with an overview of us and discuss the requested materials. At the meeting, we agreed on some minor changes in the requested materials. In addition, the Attorney General's Office indicated that they would review the materials we provided to them and if there were any concerns they would contact us to meet, discuss and resolve the concerns. We will continue to fully cooperate with the state's Attorney General's Office in responding to the demand and any follow up discussions with them. The Texas Attorney General has requested additional information and documentation from time to time, most recently in February 2010 when it requested clarifying information limited to vehicle inspections, after sale repairs, warranty, loan servicing, and consumer concerns. We believe the request is routine in nature and we have responded accordingly. We believe we are in compliance with all applicable state laws and regulations and we intend to continue to cooperate with state officials. We believe we do not have any qualitative or quantitative loss contingencies related to this matter.

We are currently appealing to the Nevada Supreme Court on an adverse administrative ruling related to the efficacy of certain sales tax refunds we have requested for the 2002 and 2003 tax years. While only applicable to 2002 and 2003, an adverse ruling could affect subsequent tax years as well. In several of our states, we file for and receive sales tax refunds for sales taxes paid on retail installment sales of the amount related to that portion of the sales price ultimately not collected from our customers. Prior to this adverse ruling, the Department of Taxation of the State of Nevada had, in an audit of tax years 1998-2001, allowed such refunds. The Department is now taking the position that because the contracts are assigned to our related finance company (which they were in certain of our prior periods as well) we are not entitled to the refund. We are vigorously pursuing our rights to the refunds and believe we have a positive position and will prevail in this proceeding. Total sales tax refunds from 2002 through June 30, 2010 were \$4.9 million. We have not accrued any amounts with respect to this matter.

On June 9, 2009, a former customer filed a complaint in Los Angeles County Superior Court, alleging the post repossession notice sent to the former customer was materially defective and incomplete. The plaintiff brought the case as a purported class action in a representative capacity under California's Unfair Competition Law. The parties entered into negotiations and reached a settlement, which the court preliminarily approved on April 22, 2010. The court subsequently granted final approval and we have paid the settlement in the second quarter of 2010. The amount was previously accrued at December 31, 2009 and was sufficient to cover the settlement.

Additionally, in the ordinary course of business, we are a defendant in various other types of legal proceedings. Although we cannot determine at this time the amount of the ultimate exposure from these lawsuits, if any, based on the advice of counsel management does not expect the final outcome to have a material adverse effect on us.

(11) Fair Value of Financial Instruments

Generally Accepted Accounting Principles require that we disclose estimated fair values for our financial instruments. Fair values are based on estimates using quoted market prices, discounted cash flows, or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and the estimated timing and amount of future cash flows. Therefore, the estimates of fair value may differ substantially from amounts that ultimately may be realized or paid at settlement or maturity of the financial instruments and those differences may be material. Accordingly, the aggregate fair value amounts presented do not represent our underlying value.

Limitations

Fair value estimates are made at a specific point in time and are based on relevant market information and information about the financial instrument; they are subjective in nature and involve uncertainties, matters of judgment and, therefore, cannot be determined with ultimate precision. These estimates do not reflect any premium or discount that could result from offering for sale at one time our entire holdings of a particular instrument. Changes in assumptions could significantly affect these estimates.

Since the fair value is estimated as of each balance sheet date presented, the amounts that will actually be realized or paid in settlement of the instruments could be significantly different.

The following is a summary of carrying value and fair value of our financial instruments for each period presented:

	June 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(\$ in thousands)			
	(Unaudited)			
Finance Receivables, net ⁽¹⁾	\$ 1,185,766	\$ 1,247,134	\$ 1,107,332	\$ 1,133,936
Portfolio Warehouse Facilities	203,902	203,902	77,506	77,506
Repurchase Facility	—	—	12,231	12,231
Pooled Auto Loan Program Financings.....	250,565	256,800	527,324	545,400
Portfolio Term Residual Financing.....	100,000	100,000	—	—
Securitization Debt	175,528	156,464	268,533	269,461
Revolving Inventory Facility	40,000	40,600	50,000	50,000
Junior Secured Notes Payable	—	—	62,088	62,088
Mortgage Note Payable	12,953	9,800	13,046	9,400
Senior Secured Notes Payable	197,725	200,500	—	—
Senior Unsecured Notes Payable.....	1,495	1,495	1,487	1,487
Equipment Note Payable-Aircraft	2,644	2,644	—	—
Subordinated Notes Payable	—	—	75,000	69,000

(1) Represents finance receivable principal balances, plus accrued interest, less the allowance for credit losses.

Valuation methodologies

Finance receivables

The fair value of finance receivables was estimated by discounting future cash flows expected to be collected using current rates at which similar loans would be made to borrowers with similar credit ratings and the same remaining maturities. This discounted cash flow is estimated utilizing internal valuation models, which use a combination of market inputs (i.e. discount rates for similar and like transactions) and our own assumptions regarding credit losses, recoveries, and prepayment rates in our portfolio. We estimate the cash flow of the portfolio and the cash flow of our retained interests in securitization and PALP transactions in measuring total cash flow. These cash flows are developed on a leveraged basis since our receivable portfolio is financed by these debt instruments and are not separable transactions.

Portfolio warehouse facilities

The portfolio warehouse facilities are short term in nature and the interest rates adjust in conjunction with the lender's cost of funds or 30-day LIBOR. Warehouse facility I was amended in July 2010 to reduce its capacity from \$250.0 million to \$150.0 million and we extended the maturity from December 2010 to December 2011, with no change in interest rate required by the lender. Therefore, we believe the fair value of this facility approximates carrying value at June 30, 2010. Warehouse facility II was executed in May 2010, in close proximity to June 30, 2010 and contains a floating market rate of interest, therefore, we believe the fair value of this facility approximates carrying value at June 30, 2010. Warehouse facility III was executed in April 2010, in close proximity to June 30, 2010 and contains a floating market rate of interest, therefore, we believe the fair value of this facility approximates carrying value at June 30, 2010.

Pooled auto loan program financings

The fair value of PALP debt at June 30, 2010 is based on third party discounted cash flow using market interest rates for this debt.

Portfolio term residual financing

In May 2010, we entered into a \$350.0 million combined warehouse and warehouse residual facility. This facility allows for maximum borrowings under a term component of \$100.0 million bearing a fixed rate of interest of

8.62%. Since this debt instrument was executed within close proximity to June 30, 2010, we believe the fair value of this debt approximates carrying value at June 30, 2010.

Securitization debt

The fair value of securitization debt was estimated using third party quoted market prices.

Revolving inventory facility

At June 30, 2010, the fair value of the inventory facility was determined third party discounted cash flow using market interest rates for this debt.

Mortgage note payable

At June 30, 2010 the fair value of this note was determined using third-party market prices for similar commercial real estate mortgages.

Senior secured notes payable

The fair value of senior secured notes payable at June 30, 2010 was determined using third party quoted market prices.

Senior unsecured notes payable

At June 30, 2010, the fair value of the senior unsecured notes was determined to be par due to the short term to maturity and our ability to pre-pay the balance remaining.

Equipment note payable

The equipment note payable was executed in April 2010, in close proximity to June 30, 2010, therefore, we believe the fair value of this debt instrument approximates carrying value.

(12) Subsequent Events

We have evaluated subsequent events potential recognition and/or disclosure through August 13, 2010, or the date the financial statements were available for issuance.

Accordingly, the following disclosures apply:

In July 2010, we entered into a fourth portfolio warehouse facility agreement with RBS with a capacity of \$50.0 million, which expires in July 2011. This facility is secured primarily by finance receivables and carries an advance rate on the receivables pledged to the facility of 50%. The amounts outstanding under the facility bear interest at the lenders' cost of funds thereunder plus 2.50%. The loan agreement provides an option to increase the capacity to \$100.0 million in January 2011.

In July 2010, we amended warehouse facility I, decreasing the total capacity from \$250.0 million to \$150.0 million, reducing the demand note from \$25.0 million to \$15.0 million, and extending the maturity from December 2010 to December 2011. As a result of this amendment we wrote-off \$1.1 million of unamortized deferred financing costs in July 2010. This facility is secured by finance receivables and carries an advance rate on the receivables pledged to the facility of 58%. The amounts outstanding under the facility bear interest based on the lenders' cost of funds thereunder plus 4.25% on or prior to December 31, 2010. Thereafter the amounts outstanding under the facility will bear interest based on the lenders' cost of funds thereunder plus 3.25%.

In August 2010, the board of directors approved \$12.7 million of dividends to be distributed to our shareholder and we effected the distribution on August 16, 2010.

In August 2010, we extended the term of our revolving inventory facility 30 days and this facility now expires in September 2009.

(13) Recent Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (FASB) or other accounting standards setting bodies, which we may adopt as of the specified date required by each standard. Unless otherwise discussed, we believe the impact of recently issued standards that are not yet effective will not have a material impact on our consolidated financial statements upon adoption. The below information is not a comprehensive list of all new pronouncements. We have only included those pronouncements we believe the reader of the financial statements would find meaningful. We have excluded certain pronouncements that we believe do not apply to us or the industry in which we operate.

In January 2010, the FASB issued guidance that clarifies and requires disclosure of amounts and reasons for significant transfers between Level 1 and Level 2, as well as significant transfers in and out of Level 3 of the fair value hierarchy. The new guidance also requires that purchases, sales, issuances, and settlements be presented gross in the Level 3 reconciliation and that requirement is effective for fiscal years beginning after December 15, 2010 and for interim periods within those years, with early adoption permitted. As we did not elect the fair value option for our financial assets and liabilities we do not believe the implementation of this standard will have a significant impact on our consolidated financial statements, except to the extent it modifies our fair value disclosures in our current consolidated financial statements.

On February 10, 2010, the FASB issued ASU 2010-09 to amend certain recognition and disclosure requirements regarding subsequent events. This ASU became effective on the issue date and it did not have a material impact on our consolidated financial position, results of operations or cash flows.

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

The following discussion of our historical results of operations and our liquidity and capital resources should be read in conjunction with the financial statements and related notes that appear elsewhere in this report. Unless otherwise indicated in this Quarterly Report on Form 10-Q, the terms "DriveTime," the "Company," "we," "our" and "us" refer to DriveTime Automotive Group, Inc. and DT Acceptance Corporation and their respective subsidiaries as a consolidated entity.

Overview

We are the leading used vehicle retailer in the United States with a sole focus on the sale and financing of quality vehicles to the subprime market. Through our branded dealerships, we provide our customers with a comprehensive end-to-end solution for their automotive needs, including the sale, financing, and maintenance of their vehicles. As of June 30, 2010, we owned and operated 81 dealerships and 13 reconditioning facilities in 21 geographic regions in 13 states. For the six months ended June 30, 2010, we sold 28,587 vehicles, generated \$542.8 million of total revenue (which consists of vehicle sales and interest income), and generated \$116.4 million of Adjusted EBITDA. We provide our customers with financing for substantially all of the vehicles we sell. As of June 30, 2010, our loan portfolio had a total outstanding principal balance of \$1.4 billion. We maintain our loan portfolio and related financings on our balance sheet.

Over the past 18 years, we have developed an integrated business model that consists of vehicle acquisition, reconditioning, sales, underwriting and finance, loan servicing, and after sale support. We believe that our model enables us to operate successfully in the underserved subprime market segment. In addition, we believe that our model allows us to systematically open new dealerships in existing and new markets throughout the United States.

Our integrated business model is focused on giving our customers the ability to acquire quality used vehicles through six key activities:

- *Vehicle acquisition.* We acquire inventory primarily from used vehicle auctions. Our centralized vehicle selection strategy takes into account many factors, including the retail value, age, and costs of buying, reconditioning, and delivering the vehicle for resale, along with buyer affordability and desirability. For the six months ended June 30, 2010, we purchased 26,888 vehicles from 170 auctions nationwide.
- *Vehicle reconditioning and distribution.* Subsequent to acquisition, vehicles are transported to one of our 13 regional reconditioning facilities, where we recondition the vehicles and perform a rigorous multi-point inspection for safety and operability. On average, we spend approximately \$750 to \$1,000 in reconditioning costs per vehicle sold, including parts and labor. Upon passing our quality assurance testing, we determine the distribution of vehicles to our dealerships based on current inventory mix and levels, along with sales patterns at each dealership.
- *Vehicle sales.* We focus on selling quality used vehicles with affordable payments through our extensive network of company-owned dealerships. We utilize targeted television, radio, and online advertising programs to promote our brand and encourage customers to complete an online credit application and visit our dealerships. Approximately 53% of our customers completed an online credit application before visiting one of our dealerships in the six month period ended June 30, 2010. Our dealerships are generally located in high traffic commercial districts and showcase our DriveTime logos and color schemes.
- *Underwriting and finance.* Using information provided as part of the credit application process, our centralized proprietary credit scoring system determines a customer's credit grade and the corresponding minimum down payment and maximum installment payment. We monitor the performance of our portfolio and close rates on a real-time basis, allowing us to centrally adjust pricing and financing terms to balance sales volumes and loan performance.
- *Loan servicing.* We perform all servicing functions for our loan portfolio, from collections through the resale of repossessed vehicles. We allow customers to make payments in cash at over 3,700 Wal-Mart stores and more than 10,000 other locations nationwide, as well as through traditional payment methods. Our experienced collection staff utilizes our proprietary collection software, which we developed specifically for subprime auto loans. We use behavioral models designed to predict payment habits, as well as automated

dialer and messaging systems to enhance collection efficiency. We utilize our vehicle acquisition and sales expertise in representing our vehicles at auction in order to maximize the recovery value of repossessed vehicles.

- *After sale support.* As part of our no-haggle vehicle sale price, we provide a warranty on each vehicle we sell, and in December 2009 we extended our warranty program (which is included in the sales price of each vehicle) to cover 36 months / 36,000 miles, including oil changes at Sears automotive locations nationwide and 24/7 roadside assistance. We self-administer our warranty program through our in-house team of customer service representatives, including warranty claim specialists who are certified mechanics, and our pre-approved vendor network of independent third-party repair facilities.

We believe that our business model has several advantages over our competition and that we provide our customers with a unique buying experience featuring:

- (1) branded, attractive dealership facilities, each of which maintains a large inventory of quality, reconditioned used vehicles;
- (2) professional and courteous service with “no haggle” pricing and a three day “no questions asked” return policy;
- (3) vehicle financing with affordable down payments and installment payments;
- (4) our DriveCare® limited warranty program (included in the sales price of each vehicle) – a 36 month / 36,000 mile major mechanical warranty, including oil changes at Sears automotive locations nationwide and 24/7 roadside assistance; and
- (5) numerous payment options, which include cash payments at alternative retail and other locations nationwide, as well as online, by phone, and through other traditional payment methods.

To provide financing to our customers, we have traditionally relied upon portfolio warehouse facilities and securitization transactions.

Second Quarter 2010 Highlights

- In June 2010 we issued \$200.0 million of 12.625% senior secured notes due June 15, 2017. The notes were issued with an original issuance price of 98.854%, resulting in an effective yield of 12.875%.
- Our sole shareholder exchanged \$100.1 million of debt in the form of junior secured notes and subordinated notes, to an equal amount of paid-in capital, thereby increasing our total equity accordingly.
- In May 2010, we entered into a \$350.0 million combined warehouse and residual facility which allows for maximum borrowings under a term residual component of \$100.0 million with an advance rate of 75% and under a revolving component of \$250.0 million, with an advance rate of 70%.
- In April 2010, we entered into a portfolio warehouse facility which allows for maximum borrowings of \$125.0 million with an advance rate of 50%.
- Total revenue increased 5.5% from \$233.0 million for the three months ended June 30, 2009 to \$245.7 million for the three months ended June 30, 2010.
- Unit sales increased 2.9% from 11,941 for the three months ended June 30, 2009 to 12,284 for the three months ended June 30, 2010.
- Net charge-offs as a percent of average portfolio principal outstanding decreased from 3.9% for the three months ended June 30, 2009 to 2.5% for the three months ended June 30, 2010.
- We opened two new stores in our South Carolina region. Through July 31, 2010, we have opened a total of five stores in new geographic regions.

Internal Controls

We have material weaknesses in internal control over financial reporting. In April 2010, we identified a matter involving a control deficiency in our internal control over financial reporting that constituted a material weakness.

We have concluded that there is more than a remote likelihood that a material misstatement of our annual or interim financial statements would not be prevented or detected on a timely basis by our employees in the normal course of performing their assigned functions.

We are in the process of remediating this material weakness and expect to have controls in place and tested by December 31, 2010.

Material Weakness

In April 2010 we identified an error related to recording the effect of a transaction between related parties. In January 2008, Mr. Garcia entered into an agreement directly with Mr. Fidel (not between the Company and Mr. Fidel) to purchase Mr. Fidel's 5% interest in DTAG and DTAC for \$17.5 million. The terms of the purchase were such that Mr. Garcia paid Mr. Fidel \$6.25 million in cash and \$11.25 million in a promissory note bearing interest at 8.0% per annum. The term of the note is five years with annual installment payments required.

The agreement between Mr. Garcia and Mr. Fidel contains an employment condition, requiring Mr. Fidel to remain employed with the Company through June 30, 2010. Under the terms of the agreement, if Mr. Fidel voluntarily terminated his employment as the President and Chief Executive Officer of the Company at any time prior to June 30, 2010, one-half of the principal balance of the note would have been waived and would have been no longer be payable by Mr. Garcia.

Accordingly, under GAAP, \$5.63 million of the \$11.25 million note is deemed non-cash compensation expense to be recognized over the term of the employment condition between Mr. Garcia and Mr. Fidel. The Company did not originally reflect the compensation expense and the corresponding credit to equity related to this agreement in its financial statements in 2008 or 2009. Our financial statements have been restated to reflect this compensation expense. We believe that the control deficiency identified in connection with this error constitutes a material weakness in our internal control over financial reporting. Such material weakness relates to our lack of processes and effective controls for identifying and recording related party transactions not involving the Company in accordance with GAAP.

Forward-Looking Statements

This Quarterly Report on Form 10-Q, including *Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations*, contains "forward-looking statements," which include information relating to future events, future financial performance, strategies, expectations, competitive environment, regulation, and availability of resources. These forward-looking statements include, without limitation, statements concerning projections, predictions, expectations, estimates, or forecasts as to our business, financial and operational results, and future economic performance; and statements of management's goals and objectives and other similar expressions concerning matters that are not historical facts. Words such as "may," "should," "could," "would," "predicts," "potential," "continue," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," and similar expressions, as well as statements in future tense, identify forward-looking statements.

Forward-looking statements should not be read as a guarantee of future performance or results, and will not necessarily be accurate indications of the times at, or by, which such performance or results will be achieved. Forward-looking statements are based on information available at the time those statements are made or management's good faith belief as of that time with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking statements. Important factors that could cause such differences include, but are not limited to:

- we require substantial capital to finance our business;
- our focus on customers with subprime credit;
- we may not be able to generate sufficient cash flow to meet our debt service obligations;
- changes to our business plan that are currently being implemented, and those that may be implemented in the future, may not be successful and may cause unintended consequences;

- interest rates affect our profitability and cash flows and an increase in interest rates will increase our interest expense and lower our profitability and liquidity;
- general and economic conditions and their effect on automobile sales;
- we are subject to extensive governmental regulations, and if we are found to be in violation of any federal, state, or local laws or regulations applicable to us, our business could suffer;
- changes in laws, regulations, or policies;
- the need to further reduce the scope of our operations;
- seasonal and other fluctuations in our results of operations;
- our failure to effectively manage our growth, access the additional required financing to fund our growth, and increased exposure to legal and regulatory risks as a result of our plans to expand;
- we operate in a highly competitive environment, and if we are unable to compete with our competitors, our results of operations and financial condition could be materially adversely affected; and
- other factors discussed under the headings “Risk Factors,” “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Business.”
- Forward-looking statements speak only as of the date the statements are made. You should not put undue reliance on any forward-looking statements. We assume no obligation to update forward-looking statements to reflect actual results, changes in assumptions, or changes in other factors affecting forward-looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with United States generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosures of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions, impacting our reported results of operations and financial condition.

Certain accounting policies involve significant judgments and assumptions by management, which have a material impact on the carrying value of assets and liabilities and the recognition of income and expenses. Management considers these accounting policies to be critical accounting policies. The estimates and assumptions used by management are based on historical experience and other factors, which are believed to be reasonable under the circumstances. The significant accounting policies which we believe are the most critical to aid in fully understanding and evaluating our reported financial results are described below.

Revenue recognition

Revenue from the sale of used vehicles is recognized upon delivery, when the sales contract is signed, and the agreed-upon down payment or purchase price has been received. Sales of used vehicles include revenue from the sale of used vehicles, net of a reserve for returns. The reserve for returns is estimated using historical experience and trends and could be affected if future vehicle returns differ from historical averages. A 10.0% increase in our rate of returns would result in a \$0.4 million and \$0.6 million decrease in our sales return allowance at June 30, 2010 and December 31, 2009, respectively. Revenue is recognized at time of sale since persuasive evidence of an arrangement in the form of an installment sales contract exists, we have delivered the vehicle to the customer, transferred title, our sales have a fixed and determinable price, and collectability is reasonably assured.

Allowance for credit losses

We maintain an allowance for credit losses on an aggregate basis at a level we consider sufficient to cover probable credit losses inherent in our portfolio of receivables as of each reporting date utilizing a loss emergence period to cover 12 months of estimated losses. The allowance takes into account historical credit loss experience, including timing, frequency and severity of losses. This estimate of existing probable credit losses inherent in the portfolio is primarily based on static pool analyses by month of origination based on origination principal, credit grade mix and deal structure, including down payment and term. The evaluation of the adequacy of the allowance also considers factors and assumptions regarding the overall portfolio quality, delinquency status, the value of the underlying collateral, current economic conditions that may affect the borrowers' ability to pay, and the overall effectiveness of collection efforts.

The static pool loss curves by grade are adjusted for actual performance to date, and historical seasonality patterns. The forecasted periodic loss rates, which drive the forecast for estimated gross losses (before recoveries) are calculated by factoring amortization speed, and origination terms. Charge offs have a natural seasonality pattern such that they are typically lower during the first and second quarters of each calendar year because customers tend to have additional money from tax refunds to apply to their loans, compared to the third and fourth quarters when charge offs tend to increase. Recoveries are estimated using historical unit and dollar static pool recovery activity to forecast recoveries for estimated charge offs at the balance sheet date. The forecasted recovery rates (on a per unit basis) are based on the historical unit recovery trend by recovery type as adjusted for estimated impact of economic and market conditions.

The allowance model is sensitive to changes in assumptions such that an increase or decrease in our forecasted net charge-offs would increase or decrease the allowance as a percentage of principal outstanding required to be maintained. The amount of our allowance is sensitive to losses within credit grade, recovery values, deal structure, the loss emergence period and overall credit grade mix of the portfolio. In the event loss assumptions used in the calculation of the allowance for credit losses were to increase, there would be a corresponding increase in the amount of the allowance for credit losses, which would decrease the net carrying value of finance receivables and increase the amount of provision for credit losses, thereby decreasing net income. A 5% increase in our frequency loss assumption would increase the allowance for credit losses and our provision for credit losses by \$9.7 million and \$9.2 million as of June 30, 2010 and December 31, 2009, respectively. Also, a 5% decrease in our assumed recoveries per loan charged off, would result in an increase to the allowance for credit losses and provision for credit losses by \$4.1 million and \$3.9 million as of June 30, 2010 and December 31, 2009, respectively. Our ability to forecast net charge-offs and track static pool net losses by month of origination are a critical aspect of this analysis.

Although it is reasonably possible that events or circumstances could occur in the future that are not presently foreseen, which could cause actual credit losses to be materially different from the recorded allowance for credit losses, we believe that we have given appropriate consideration to the relevant factors and have made reasonable assumptions in determining the level of the allowance. Our credit and underwriting policies and adherence to such policies and the execution of collections processes have a significant impact on collection results, as well as the economy as a whole. Changes to the economy, unemployment, auction prices for repossessed vehicles, and collections and recovery processes could materially affect our reported results.

Recovery receivables

All loans over 90 days past due at month end are charged off. Recovery receivables consist of estimated recoveries to be received on charged off receivables, including proceeds from selling repossessed vehicles at auction, along with insurance, bankruptcy and deficiency collections. The recovery amount from selling repossessed vehicles at auction is a forecast of vehicles to be recovered from loans previously charged-off and vehicles currently in our possession. Based on our extensive experience and historical database of auction recoveries, we estimate the number of units we will recover and the value that we will receive for these vehicles at auction. Our forecast utilizes historical data with respect to recovery rates, values, and time from charge-off to repossession. In order to estimate auction recoveries we utilize historical static pool unit recovery rates as adjusted for recent market trends to arrive at the forecasted recovery dollars by static pool month of charge-offs. Insurance, bankruptcy and deficiency collections are estimated using historical trends adjusted for changes to recovery practices.

Valuation of inventory

Inventory consists of used vehicles held-for-sale or currently undergoing reconditioning and is stated at the lower of cost or market value. Vehicle inventory cost is determined by specific identification. Direct and indirect vehicle reconditioning costs including parts and labor, costs to transport the vehicles to our dealership locations, buyer costs, and other incremental costs are capitalized as a component of inventory cost. Determination of the market value of inventory involves assumptions regarding wholesale loss rates derived from historical trends and could be affected by changes in supply and demand at our retail locations and at the auctions. A 1.0% decrease in the valuation of our inventory at June 30, 2010 would result in a decrease in net income of approximately \$1.0 million.

Secured financings

Securitizations

We sell loans originated at our dealerships to our bankruptcy-remote securitization subsidiaries, which, in turn, transfer the loans to separate trusts that issue notes and certificates collateralized by these loans. The senior class notes are sold to investors, and we retain the subordinate classes. We continue to service all securitized loans. Due to certain restrictions placed on the trusts (i.e., the trusts do not have the right to pledge the assets), securitization transactions have been accounted for as secured financings, in accordance with ASC 860 – Transfers and Servicing. Loans included in the securitization transactions are recorded as finance receivables and the asset-backed securities that are issued by the trusts are recorded as a component of portfolio term financings in the accompanying consolidated balance sheets.

Pooled auto loan program transactions

Under Pooled Auto Loan Program (PALP) transactions, we pool contracts originated at our dealerships and sell them to either (i) a special purpose entity which transfers the loans to a separate trust which, in turn, issues a note collateralized by the loans; or (ii) we sell the pooled loans, in a secured financing transaction, directly to a third-party financial institution. We retain all servicing. Both types of PALP transactions are accounted for as secured financings either due to our right to repurchase the loans sold at a specified date or due to restrictions placed on the trust. Therefore, the loan contracts included in the transactions remain in finance receivables and the debt is reflected as portfolio term financings on the consolidated balance sheets.

Limited warranty

A liability for the estimated cost of vehicle repairs under our DriveCare® limited vehicle warranty program is established at the time a used vehicle is sold by charging costs of used vehicles sold. Starting with sales in December 2009, the DriveCare® limited warranty plan was extended to 36 months / 36,000 miles, and includes oil changes at Sears automotive locations nationwide and 24/7 roadside assistance. The liability is evaluated for adequacy through an analysis based on a combination of the program's historical performance of warranty cost incurred per unit sold over the term of the warranty and on actuarial information provided by a third party. The accrual for oil changes is based on 100% utilization of this coverage, since non-use of the oil change could void the customer's warranty. Our liability is affected by the number of vehicles that come back for repair under warranty, the number of oil changes utilized, and our estimated cost per repair, couple with the actuarial results provided. These assumptions are further affected by mix and age of vehicles sold and our ability to recondition vehicles prior to sale. A 10.0% increase in our warranty accrual at June 30, 2010, would result in a reduction in net income of approximately \$0.8 million for both the three and six months ended June 30, 2010.

Factors Affecting Comparability

We have set forth below selected factors that we believe have had, or can be expected to have, a significant effect on the comparability of recent or future results of operations:

Reporting company expenses

Our 12.625% Senior Secured Notes due 2017 require us to file a registration statement on Form S-4 with the SEC and to make an offer to exchange the notes for registered publicly tradable notes that have substantially identical terms. Upon effectiveness of this registration statement we will become subject to a number of additional requirements, including the reporting requirements of the Exchange Act and certain related requirements of the Sarbanes-Oxley Act. As a result, we expect that our general and administrative expenses will increase as we pay our employees, legal counsel, and accountants to assist us in, among other things, establishing and maintaining internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act, and preparing and distributing periodic public reports under the federal securities laws. We estimate that incremental costs associated with being an SEC registrant will be between \$2.5 million and \$4.0 million annually.

Limited warranty

Starting with sales in December 2009, we extended our DriveCare® limited warranty plan from six months / 6,000 miles to 36 months / 36,000 miles, and it now includes lifetime oil changes at Sears automotive locations nationwide and 24/7 roadside assistance. As a result, we expect that our warranty costs will be higher in future periods, however, we believe that the warranty will have a positive impact on vehicle sales and loan performance.

Interest expense

As a result of the issuance of our 12.625% Senior Secured Notes due 2017 and the use of proceeds there from to repay certain of our indebtedness, and the contribution of an aggregate of \$100.1 million of subordinated notes and junior secured notes into equity in connection with the offering of our 12.625% Senior Secured Notes due 2017, as well as the execution of three new warehouse facilities, which are secured by finance receivables, we expect that our weighted average cost of funds will be lower in future periods. To the extent our average amount borrowed is also less in future periods, we would expect a decrease in our interest expense in future periods.

Selected Historical Consolidated Financial and other data

The following table sets forth our selected historical consolidated financial and operating data as of the dates and for the periods indicated.

	As of and for the Three Months Ended June 30,		As of and for the Six Months Ended June 30,	
	2010	2009	2010	2009
(\$ in thousands, except per vehicle sold data) (Unaudited)				
Dealerships:				
Dealerships in operation at end of period	81	79	81	79
Average number of vehicles sold per dealership per month	51	50	60	58
Retail Sales:				
Number of used vehicles sold.....	12,284	11,941	28,587	27,728
Average age of vehicles sold (in years).....	4.4	4.2	4.4	4.2
Average mileage of vehicles sold.....	69,234	67,411	69,234	66,860
Per vehicle sold data:				
Average sales price.....	\$ 14,515	\$ 14,143	\$ 14,444	\$ 14,208
Average cost of vehicle sold.....	\$ 9,296	\$ 7,898	\$ 8,980	\$ 7,919
Average gross margin.....	\$ 5,219	\$ 6,245	\$ 5,464	\$ 6,289
Gross margin percentage	36.0%	44.2%	37.8%	44.3%
Loan Portfolio:				
Number of applications	43,756	45,264	95,535	97,028
Close rate percentage ⁽¹⁾	28.1%	26.4%	29.9%	28.6%
Principal balances originated.....	\$ 175,479	\$ 167,014	\$ 402,140	\$ 387,185
Average amount financed per origination.....	\$ 14,291	\$ 13,990	\$ 14,075	\$ 13,968
Number of loans outstanding—end of period.....	135,267	130,007	135,267	130,007
Principal outstanding—end of period.....	\$ 1,392,152	\$ 1,377,040	\$ 1,392,152	\$ 1,377,040
Average principal outstanding – beginning of period	\$ 1,380,353	\$ 1,380,759	\$ 1,352,807	\$ 1,365,865
Average effective yield on portfolio ⁽²⁾	20.2%	19.5%	19.9%	19.3%
Allowance for credit losses as a percentage of portfolio principal.....	15.9%	17.8%	15.9%	17.8%
Portfolio performance data:				
Portfolio delinquencies over 30 days ⁽³⁾	7.1%	6.9%	7.1%	6.9%
Principal charged-off as a percentage of outstanding principal.....	4.2%	5.6%	9.8%	12.8%
Recoveries as a percentage of principal charged-off.....	41.0%	31.4%	41.3%	31.4%
Net charge-offs as a percentage of average principal.....	2.5%	3.9%	5.7%	8.8%
Financing and Liquidity:				
Unrestricted cash and availability ⁽⁴⁾	\$ 225,264	\$ 81,445	\$ 225,264	\$ 81,445
Ratio of net debt to shareholder's equity ⁽⁵⁾	2.2x	3.1x	2.2x	3.1x
Secured collateral coverage ratio ⁽⁶⁾	2.7x	N/A	2.7x	N/A
Ratio of adjusted EBITDA to interest expense ⁽⁷⁾	1.9x	1.6x	2.1x	1.6x
Total assets to shareholder's equity.....	3.5x	4.4x	3.5x	4.4x
Total average secured and unsecured debt.....	\$ 1,101,313	\$ 1,033,487	\$ 1,072,909	\$ 1,060,643
Weighted average effective borrowing rate on total debt ⁽⁸⁾	10.4%	11.0%	10.2%	10.9%
Other Financial Data:				
EBITDA ⁽⁹⁾	\$ 51,686	\$ 69,407	\$ 114,497	\$ 112,958
Adjusted EBITDA ⁽⁹⁾	\$ 52,821	\$ 45,901	\$ 116,420	\$ 93,782

(1) Close rate percentage represents the percentage of customer applications for credit that result in sales of used vehicles.

(2) Average effective yield represents the interest income earned at the contractual rate (stated APR) less the write-off of accrued interest on charged-off loans and amortization of loan origination costs (which includes the write-off of unamortized loan origination costs on charged-off loans), plus interest earned on investments held in trust and late fees earned.

(3) Delinquencies are presented on a Sunday-to-Sunday basis, which reflects delinquencies as of the nearest Sunday to period end. Sunday is used to eliminate any impact of the day of the week on delinquencies since delinquencies tend to be higher mid-week.

(4) Unrestricted cash and availability consists of cash and cash equivalents plus available borrowings under the portfolio warehouse, residual, and inventory facilities, based on assets pledged or available to be pledged to the facilities.

- (5) Net debt is calculated as total debt less restricted cash and investments held in trust securing various debt facilities. Ratio of net debt to shareholder's equity is calculated as net debt divided by total shareholder's equity.
- (6) Defined as the ratio of (i) the sum of (a) the net finance receivables, (b) net inventory, and (c) the aggregate amount of cash and cash equivalents held as collateral, to (ii) aggregate principal amount of the notes.
- (7) Represents ratio of adjusted EBITDA to total interest expense (secured and unsecured).
- (8) Weighted average effective borrowing rate includes the effect of amortization of discounts, debt issuance costs, and unused line fees.
- (9) See definition of EBITDA and Adjusted EBITDA in Management's Discussion and Analysis – Non-GAAP discussion.

Results of Operations

The following table sets forth our results of operations for the periods indicated:

	Three Months Ended			Six Months Ended		
	June 30,		% Change	June 30,		% Change
	2010	2009		2010	2009	
	(\$ in thousands)			(\$ in thousands)		
Revenue:						
Sales of Used Vehicles	\$ 178,303	\$ 168,877	5.6%	\$ 412,923	\$ 393,968	4.8%
Interest Income	67,444	64,148	5.1%	129,862	125,802	3.2%
Total Revenue	245,747	233,025	5.5%	542,785	519,770	4.4%
Costs and Expenses:						
Cost of Used Vehicles Sold	114,187	94,313	21.1%	256,709	219,576	16.9%
Provision for Credit Losses	34,342	52,302	(34.3%)	81,489	122,117	(33.3%)
Secured Debt Interest Expense	26,858	24,295	10.5%	50,286	47,186	6.6%
Unsecured Debt Interest Expense	1,640	4,170	(60.7%)	3,953	9,962	(60.3%)
Selling and Marketing	8,291	7,577	9.4%	18,221	16,572	10.0%
General and Administrative	37,241	34,231	8.8%	71,869	80,106	(10.3%)
Depreciation Expense	3,416	3,116	9.6%	6,853	6,477	5.8%
Gain on Extinguishment of Debt, net	—	(24,805)	(100.0%)	—	(31,559)	(100.0%)
Total Costs and Expenses	225,975	195,199	15.8%	489,380	470,437	4.0%
Income Before Income Taxes	19,772	37,826	(47.7%)	53,405	49,333	8.3%
Income Tax Expense	450	290	55.2%	800	660	21.2%
Net Income	\$ 19,322	\$ 37,536	(48.5%)	\$ 52,605	\$ 48,673	8.1%

Sales of used vehicles

Revenue from sales of used vehicles increased \$9.4 million, or 5.6% for the three months ended June 30, 2010 compared to the same period in 2009 and increased \$19.0 million or 4.8% for the six months ended June 30, 2010 compared to the same period in 2009. The increase in revenue was primarily due to a 2.9% and 3.1% increase in sales volume, coupled with a 2.6% and 1.7% increase in the average sales price per vehicle sold for the three and six months ended June 30, 2010 compared to the same periods in 2009, respectively. The increase in sales volume is attributable to an increase in close rates, despite a decline in application volume. The increase in average sales price per vehicle sold is attributable to an increase in the average cost of used vehicles sold as a result of a higher base acquisition cost of the vehicles acquired at auction.

Internet-related sales revenue (a component of sales of used vehicles) increased \$16.7 million, or 21.2% for the three months ended June 30, 2010 compared to the same period in 2009 and Internet-related sales revenue increased \$53.2 million, or 32.5% for the six months ended June 30, 2010 compared to the same period in 2009. As a percent of total sales revenue, internet-related sales comprised 53.6% and 52.5% of our total sales revenue for the three and six months ended June 30, 2010 and 2009, respectively, as compared to 46.7% and 41.6% for the same period in 2009. Our internet applications increased 19.7% during the three months ended June 30, 2010 and 25.4% during the six months ended June 30, 2010 compared to the same periods in 2009 as a result of our increased marketing and advertising efforts, which is directed at driving more customers to our websites to complete an application to obtain pre-approval for financing to purchase one of our vehicles.

On a same store basis, same store unit sales increased 0.4% and 2.5% and same store vehicle revenue increased 3.7% and 4.2% for the three and six months ended June 30, 2010 as compared to the same periods in 2009. These increases were the result of close rates increasing 6.8% and 5.6% for the three and six months ended June 30, 2010

compared to the same periods in 2009, which offset a decrease in customer applications of 6.1% and 2.8% for the three and six months ended June 30, 2010 compared to the same periods in 2009.

Interest income

Interest income increased \$3.3 million or 5.1% for the three months ended June 30, 2010 and increased \$4.1 million or 3.2% for the six months ended June 30, 2010. These increases are primarily due to an increase in the average effective yield on our receivables portfolio, while the average portfolio principal outstanding during these periods remained fairly consistent.

Cost of used vehicles sold

Total cost of used vehicles sold increased \$19.9 million, or 21.1% for the three months ended June 30, 2010 compared to the same period in 2009 and increased \$37.1 million or 16.9% for the six months ended June 30, 2010 compared to the same period in 2009. These increases were due to an increase in the number of vehicles sold in both periods and an increase the average cost of vehicles sold. Our cost of vehicles sold per unit increased primarily as a result of higher acquisition costs at auction and increased costs associated with our warranty as a result of increased coverage of our DriveCare® limited warranty program. Wholesale auction prices tended to increase during 2010 as compared to the same periods in 2009. Acquisition costs are a function of the vehicle make, model, and year mix that we acquire, along with vehicle wholesale auction price trends for the segment of vehicles that we target for acquisition.

Gross margin

Gross margin decreased \$10.4 million and \$18.2 million for the three and six months ended June 30, 2010, compared to the same periods in 2009. Gross margin as a percentage of sales revenue decreased to 36.0% for the three months ended June 30, 2010 from 44.2% for the same period in 2009 and decreased to 37.8% for the six months ended June 30, 2010 from 44.3% for the same period in 2009. The decrease in gross margin for both the three and six months ended June 30, 2010 is primarily attributable to an increase in our average acquisition cost per vehicle sold as a result of an increase in vehicle wholesale auction prices during these periods, as well as an increase in our cost of vehicles sold related to the cost of our 36 month / 36,000 mile warranty, and only a portion of these costs were passed on to our customers through an increase in sales price.

Provision for credit losses

Provision for credit losses decreased \$18.0 million or 34.3% for the three months ended June 30, 2010 compared to the same period in 2009 and decreased \$40.6 million or 33.3% for the six months ended June, 2010 compared to the same period in 2009. These decreases were primarily attributable to a decrease in net charge-offs due to tightening our loan underwriting standards on loan originations beginning in the second quarter of 2008, coupled with an increase in recoveries as a percent of principal charged off and a decrease in the allowance as a percentage of outstanding principal due to the improved quality of our finance receivable portfolio.

Net charge-offs as a percent of average outstanding principal decreased to 2.5% and 5.7% for the three and six months ended June 30, 2010 compared to 3.9% and 8.8% for the same periods in 2009. This improvement is a result of the tightening of our loan underwriting standards beginning in the second quarter of 2008. As a result, gross principal charged-off decreased to 4.2% for the three months ended June 30, 2010, from 5.6% for the same period in 2009 and gross principal charged-off decreased to 9.8% for the six months ended June 30, 2010 from 12.8% for the same period in 2009. In addition, recoveries as a percentage of principal charged off increased to 41.0% for the three months ended June 30, 2010 compared to 31.4% for the same period in 2009 and recoveries increased to 41.3% for the six months ended June 30, 2010 compared to 31.4% for the same period in 2009. The improvement in recoveries is due primarily to higher auction values, improved effectiveness of our repossession efforts, and the increase in seasoning of our loan portfolio.

The allowance for credit losses increased \$3.7 million from December 31, 2009 to June 30, 2010, which, as a percentage of principal outstanding balance, represented a decrease from 16.6% at December 31, 2009 to 15.9% at June 30, 2010. The decrease in the allowance as a percent of outstanding principal balance is due primarily to the improved performance and credit quality of our portfolio due to the tightening of our loan underwriting standards

beginning in the second quarter of 2008. At June 30, 2010, approximately 79.8% of our portfolio represents loans that were originated post-credit tightening.

Secured debt interest expense

Total secured debt interest expense increased \$2.6 million or 10.5% for the three months ended June 30, 2010 compared to the same period in 2009. Total secured debt interest expense increased \$3.1 million or 6.6% for the six months ended June 30, 2010 compared to the same period in 2009. These increases were primarily the result of the execution of 12.625% senior secured notes due 2017 in June 2010 as well as the execution of two new warehouse facilities in the second quarter of 2010. The weighted average effective rate on secured debt for the three and six months ended June 30, 2010 was 10.3% and 10.1%, respectively, compared to 10.9% and 10.6% for the same periods in 2009, respectively.

Unsecured debt interest expense

Unsecured debt interest expense decreased \$2.5 million or 60.7% for the three months ended June 30, 2010 compared to the same period in 2009. Unsecured debt interest expense decreased \$6.0 million or 60.3% for the six months ended June 30, 2010 compared to the same period in 2009. These decreases were primarily due to a shift in amounts outstanding under secured versus unsecured debt facilities. In addition, \$40.0 million of subordinated debt was exchanged for equity, as noted above. A primary use of proceeds from the execution of our 12.625% senior secured notes due 2017 was to pay down or pay-off existing unsecured indebtedness. The weighted average effective rate on secured debt for the three and six months ended June 30, 2010 was 12.2% and 12.3%, respectively, compared to 12.2% and 12.3% for the same periods in 2009, respectively.

Selling and marketing expense

Selling and marketing expenses increased \$0.7 million or 9.4% and \$1.6 million or 10.0% for the three and six months ended June 30, 2010, respectively, compared to the same periods in the prior year. These increases were due to an increase in our advertising expenses, primarily related to our television and internet marketing strategy, including an increased focus on advertising for our new 36 month / 36,000 mile limited warranty, in conjunction with advertising associated with preparing to open various stores in new geographic locations.

General and administrative expense

General and administrative expenses increased \$3.0 million or 8.8% and decreased \$8.2 million or 10.3% for the three and six months ended June 30, 2010, respectively, compared to the same periods in the prior year. The increase in the second quarter of 2010 compared to 2009 is related to an increase in the average number of dealerships in operation, professional services and consulting fees attributable to our preparation for filing periodic reports with the U.S. Securities and Exchange Commission as a voluntary public registrant, the write-off of accumulated costs associated with preparing for an initial public offering which we decided not to pursue in the second quarter 2010, an increase in telecom expenses for various infrastructure projects, and lease termination fees related to information technology equipment.

General and administrative expenses decreased for the six months ended June 30, 2010 due to fewer stores in operation during 2010 as a result of the closure nine stores and two reconditioning facilities in the first quarter of 2009, as well as a decrease of \$7.6 million in legal expenses relating to a legal settlement in the first quarter of 2009, whereas we did not incur such expense in 2010. These decreases were partially offset by store closing costs of \$3.7 million and \$0.4 million expensed in the three months ended March 31, 2009 and 2010, respectively.

Gain on extinguishment of debt, net

During the three and six months ended June 30, 2009, we repurchased outstanding indebtedness in aggregate principal amounts of \$75.0 million and \$103.2 million, respectively, resulting in net gains on the extinguishment of debt of \$24.8 million and \$31.6 million, respectively. By comparison did not repurchase any debt during the three and six months ended June 30, 2010.

Net income

Net income for the three months ended June 30, 2010 decreased to \$19.3 million from \$37.5 million for the three months ended June 30, 2009. Excluding gain on extinguishment of debt of \$24.8 million, net income would have increased \$6.6 million for the second quarter 2010 compared to the same period in 2009. Contributing to the \$6.6 million increase were a lower provision for credit losses due to improved loan portfolio performance, partially offset by a decrease in gross margin from the sale of used vehicles, and an increase in general and administrative, selling and marketing, and depreciation expenses.

Net income for the six months ended June 30, 2010 increased to \$52.6 million from \$48.7 million for the six months ended June 30, 2009. Excluding gain on extinguishment of debt of \$31.6 million, net income would have increased \$35.5 million for the six months ended June 30, 2010. This increase is primarily attributable to an increase in interest income, a lower provision for credit losses (as described above), a decrease in total interest expense, and a decrease in general and administrative expenses, partially offset by a decrease in gross margin from the sale of used vehicles.

Originations

The following table sets forth information regarding our originations for the periods indicated.

	Three Months Ended			Six Months Ended		
	June 30,		Change	June 30,		Change
	2010	2009		2010	2009	
(\$ in thousands except per loan data)						
Amount originated	\$ 175,479	\$ 167,014	5.1%	\$ 402,140	\$ 387,185	3.9%
Number of loans originated	12,279	11,938	2.9%	28,571	27,720	3.1%
Average amount financed per origination.....	\$ 14,291	\$ 13,990	\$ 301	\$ 14,075	\$ 13,968	\$ 107
Average APR originated	22.4%	20.7%	8.2%	22.4%	20.6%	8.7%
Average term (in months).....	54.5	51.1	3.4	53.3	51.7	1.6
Average down payment per origination.....	\$ 1,200	\$ 1,097	\$ 103	\$ 1,350	\$ 1,186	\$ 164
Down payment as a percent of amount financed	8.4%	7.8%	7.7%	9.7%	8.5%	14.1%
Percentage of sales revenue financed	98.4%	98.9%	(0.5%)	97.4%	98.3%	(0.9%)
Close rate percentage	28.1%	26.4%	6.4%	29.9%	28.6%	4.5%

We originate loans when a customer finances the purchase of one of our vehicles, and the balance on these loans, together with accrued interest and unamortized loan origination costs, comprises our portfolio of finance receivables. Receivables are financed to generate liquidity for our business. See “–Liquidity and Capital Resources.”

The principal amount of loans we originated increased \$8.5 million and \$15.0 million for the three and six months ended June 30, 2010, respectively, and we originated 2.9% and 3.1% more loans for the three and six months ended June 30, 2010 compared to the same periods in 2009. These increases were due to an increase in the number of used vehicles sold, and an increase in the average amount financed per loan originated as a direct result of an increase in the average sales price per vehicle sold, despite an increase in the average down payment per loan originated. Average APR for loans originated increased from 20.7% to 22.4% for the three months ended June 30, 2009 to 2010 and increased from 20.6% to 22.4% for the six months ended June 30, 2009 to 2010 due to changes in our overall interest rate pricing strategy.

Receivables portfolio

The following table shows the characteristics of our finance receivables portfolio for the periods indicated:

	As of and for the			As of and for the		
	Three Months Ended June 30,			Six Months Ended June 30,		
	2010	2009	Change	2010	2009	Change
	(\$ in thousands except per loan data)					
Principal balance receivable, end of period	\$ 1,392,152	\$ 1,377,040	\$ 15,112	\$ 1,392,152	\$ 1,377,040	\$ 15,112
Average principal balance	\$ 1,384,240	\$ 1,380,381	\$ 3,859	\$ 1,358,963	\$ 1,367,777	\$ (8,814)
Number of loans outstanding, end of period.....	135,267	130,007	5,260	135,267	130,007	5,260
Average remaining principal per loan, end of period....	\$ 10,292	\$ 10,592	\$ (300)	\$ 10,292	\$ 10,592	\$ (300)
Weighted Average APR of contracts outstanding	21.0%	20.4%	2.9%	21.0%	20.4%	2.9%
Average age per loan (in months).....	15.2	14.1	7.8%	15.3	14.1	8.5%

Finance receivables principal balance increased \$15.1 million from June 30, 2009 to June 30, 2010 due to origination volume exceeding portfolio run-off (regular principal payments, payoffs, and charge-offs). The average age per loan (in months) increased 7.8% and 8.5% for the three and six months ended June 30, 2010, respectively, compared to the same periods in 2009, due to lower gross charge-offs and an increase in loan term.

Delinquencies

As a percentage of total outstanding loan principal balances, delinquencies over 30 days were 7.1% and 6.9% at June 30, 2010 and 2009, respectively. The increase in delinquencies is the result of a more seasoned loan portfolio as well as a change in our collection strategy for early delinquencies. In conjunction with our centralization of collections, we are utilizing messaging and dialer technologies for early delinquencies in order to achieve a more cost effective collections process. As a result, we anticipate delinquencies to be relatively higher than our historical rates, but expect this increase to level off once our efficiencies are achieved. We do not expect this increase in delinquencies to have a significant impact on charge-offs.

Seasonality

Historically, we have experienced higher revenues in the first quarter of the calendar year than in the last three quarters of the calendar year. We believe these results are due to seasonal buying patterns resulting, in part, from the receipt by many of our customers of income tax refunds during the first quarter of the year, which are a primary source of down payments on used vehicle purchases. Our portfolio of finance receivables also has historically followed a seasonal pattern, with delinquencies and charge-offs being the highest in the second half of the year.

Liquidity and Capital Resources

We require capital for the purchase of inventory, to provide financing to our customers, for working capital and for general corporate purposes, including the purchase of property and equipment, and to open new dealerships and reconditioning facilities.

We have historically funded our capital requirements primarily through operating cash flow, portfolio warehouse facilities, securitizations, PALP financings, inventory and other revolving facilities, real estate mortgage financing, and other notes payable (including junior secured notes, senior unsecured notes, and subordinated notes).

Financing sources

We currently fund our capital requirements through the following debt instruments:

- Portfolio term financings including asset backed securitizations, PALP financing arrangements, and a residual term facility, all of which offer fixed rate secured financing for our receivables portfolio.
- Portfolio warehouse facilities including three agreements with three different institutional lenders for a combined maximum capacity of \$625.0 million at June 30, 2010. Subsequent to June 30, 2010, we

amended one facility and executed a fourth with another lender bringing our combined capacity down to \$575.0 million at July 31, 2010.

- \$200.0 million - 12.625% senior secured notes due June 15, 2017. The notes were issued in June 2010 with an original issuance price of 98.854%, resulting in an effective yield of 12.875%.
- Other secured notes payable including a revolving inventory facility with a maximum capacity of \$50.0 million, a \$13.0 million mortgage loan bearing interest at 5.87% secured by our operations call center building in Mesa, Arizona, and other notes and capital leases secured by property and equipment totaling approximately \$3.0 million.
- \$1.5 million senior unsecured notes payable, which are due October 2010.

For additional details regarding these debt instruments, see Note 5 – Debt Obligations included in the condensed consolidated financial statements included elsewhere in this report.

Our warehouse facilities include certain favorable terms and conditions, including (i) the inability of the lender to subjectively lower collateral values and effectively lower the advance rate; (ii) recourse that is limited to 10% of the facility size; and (iii) limited foreclosure rights upon a default.

We actively manage utilization of our various funding sources as we seek to minimize borrowing costs through drawing on our lower cost facilities and minimizing unused line fees, while at the same time balancing the effective advance rates and liquidity generated by each of the credit facilities in order to meet our funding needs. The effective advance rates on our portfolio warehouse and term financings are based on the outstanding principal balance of the loans we originate. However, our initial investment in the loans we originate is lower than the original principal balance of the loans.

Recent financing transactions

In July 2010, we entered into a fourth portfolio warehouse facility agreement with RBS Securities, Inc. with a capacity of \$50.0 million, which expires in July 2011. This facility is secured primarily by finance receivables and carries an advance rate on the receivables pledged to the facility of 50%. The amounts outstanding under the facility bear interest at lenders' cost of funds thereunder plus 2.50%. The loan agreement provides an option to increase the capacity to \$100.0 million in January 2011.

In July 2010, we amended warehouse facility I, decreasing the total capacity from \$250.0 million to \$150.0 million, reducing the demand note from \$25.0 million to \$15.0 million, and extending the maturity from December 2010 to December 2011. As a result of this amendment we wrote-off \$1.1 million of unamortized deferred financing costs in July 2010. This facility is secured by finance receivables and carries an advance rate on the receivables pledged to the facility of 58%. The amounts outstanding under the facility bear interest based on the lenders' cost of funds there-under plus 4.25% on or prior to December 31, 2010. Thereafter the amounts outstanding under the facility will bear interest based on the lenders' cost of funds there-under plus 3.25%.

Liquidity

The following is a summary of total available liquidity, consisting of unrestricted cash and current availability under the portfolio warehouse, residual, and inventory facilities for the periods indicated:

	June 30, 2010	December 31, 2009	June 30, 2009
		(\$ in thousands)	
		(Unaudited)	
Unrestricted cash	\$ 24,409	\$ 21,526	\$ 22,125
Portfolio warehouse facilities	190,855	8,881	53,827
Inventory facility	10,000	10,000	5,493
Total liquidity	<u>\$ 225,264</u>	<u>\$ 40,407</u>	<u>\$ 81,445</u>

Changes in liquidity

Changes in liquidity are affected by increases and decreases to our operating cash flow, changes in advance rates on our portfolio warehouse facilities, capacity of our portfolio warehouse and inventory facilities, portfolio term financings, and changes in other notes payable. The following is a summary of changes in liquidity for each period presented:

	Six Months ended June 30,		Years ended December 31,		
	2010	2009	2009	2008	2007
	(\$ in thousands)				
	(Unaudited)				
Liquidity - beginning of period	\$ 40,407	\$ 50,232	\$ 50,232	\$ 126,309	\$ 121,664
Net increase (decrease) in cash and cash equivalents	2,883	(3,408)	(4,007)	(16,708)	758
Increase (decrease) in portfolio warehouse availability	181,974	29,938	(15,008)	(55,179)	64,475
Increase (decrease) in inventory facility availability	—	4,683	9,190	(4,190)	(60,588)
Liquidity - end of period	<u>\$ 225,264</u>	<u>\$ 81,445</u>	<u>\$ 40,407</u>	<u>\$ 50,232</u>	<u>\$ 126,309</u>

Our liquidity for the six months ended June 30, 2010 increased \$184.9 million, from \$40.4 million at December 31, 2009 to \$225.3 million at June 30, 2010. This increase was primarily the result of the net proceeds from the sale of our 12.625% senior secured notes in June 2010, which were used primarily to pay-down amounts outstanding under our warehouse facilities.

Cash flows

Operating activities. For the six months ended June 30, 2010, net cash provided by operating activities was \$25.1 million, as compared to \$73.6 million for the six months ended June 30, 2009. The decrease in cash provided by operating activities was primarily due to an increase in loan originations, a smaller reduction in inventory in 2010 compared to 2009, an increase in other assets in 2010 compared to a decrease in 2009, offset by a greater increase in accounts payable, accrued expenses and other liabilities.

Investing activities. For the six months ended June 30, 2010, net cash used in investing activities increased to \$5.8 million from \$4.7 million used in investing activities for the six months ended June 30, 2009. The increase in cash used in investing activities was primarily due to three new store openings in 2010 and one store under development and an increase in the addition of information technology infrastructure equipment to support our operations. We did not open any new stores during the six months ended June 30, 2009.

Financing activities. Net cash used in financing activities decreased to \$16.5 million for the six months ended June 30, 2010 from \$72.3 million used in financing activities for the same period in 2009. The reduction in cash used in financing activities is primarily related to an increase in borrowings under our warehouse facilities, which was a result of executing two new warehouse facilities and reducing one of our PALP financing agreements with one of our lenders, resulting in the pay-down of PALP while increasing warehouse borrowings. In addition, we issued \$200.0 million of 12.625% senior secured notes in June 2010, which provided net proceeds to the Company of \$155.9 million, which was used to pay down amounts outstanding under warehouse facilities and pay-off a portion of junior secured notes and subordinated notes payable to our sole shareholder.

In addition, we had a non-cash exchange of \$100.1 million of junior secured and subordinated notes for equity, thereby reducing total outstanding debt without a cash outflow.

Impact of New Accounting Pronouncements

For a discussion of recent accounting pronouncements applicable to us, see “Recent Accounting Pronouncements” in note 13 to the condensed consolidated financial statements included elsewhere in this report.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources.

Impact of Inflation

Inflation generally results in higher interest rates on our borrowings, which could decrease the profitability of our existing portfolio to the extent we have variable rate debt and could decrease profitability of our future originations if we are not able to pass the increase on to our customers. We seek to limit the risk of increasing borrowing costs:

- through our portfolio term financings, which allowed us to fix a portion of our borrowing costs and generally match the term of the underlying finance receivables, and
- by increasing the interest rate charged for loans originated at our dealerships (if allowed under applicable law) while maintaining affordability of our customers' payments.

We believe that inflation has not had a material impact on our results of operations for the six months ended June 30, 2010.

Non-GAAP Discussion

EBITDA and Adjusted EBITDA, which we refer to as the non-GAAP financial measures, are supplemental measures of our performance that are not required by, or presented in accordance with, generally accepted accounting principles in the United States ("GAAP"). The non-GAAP financial measures are not measures of our financial performance under GAAP and should not be considered as an alternative to GAAP net income (loss) or any other performance measures derived in accordance with GAAP. See the footnotes to the tables in "Summary Historical Consolidated Financial and Other Data" for definitions of the other non-GAAP financial measures.

We present non-GAAP financial measures because we consider them to be important supplemental measures of our operating performance. All of the adjustments made in our calculation of the non-GAAP financial measures are adjustments to items that management does not consider to be reflective of our core operating performance. Management considers our core operating performance to be that which can be affected by our managers in any particular period through their management of the resources that affect our underlying revenue and profit generating operations during that period.

However, because these non-GAAP financial measures are not recognized measurements under GAAP, when analyzing our operating performance investors should use these non-GAAP financial measures in addition to, and not as an alternative for, net income, operating income, or any other performance measure presented in accordance with GAAP, or as an alternative to cash flow from operating activities or as a measure of our liquidity. Because not all companies use identical calculations, our presentation of these non-GAAP financial measures may not be comparable to similarly titled measures of other companies.

Because of these limitations, EBITDA and Adjusted EBITDA and other non-GAAP financial measures should not be considered as discretionary cash available to us to reinvest in the growth of our business. You should compensate for these limitations by relying primarily on our GAAP results and using these non-GAAP financial measures supplementally.

EBITDA represents net income (loss) before income tax expense, total interest expense (secured and unsecured) and depreciation expense. Adjusted EBITDA represents EBITDA plus store closing costs, a legal settlement, non-cash compensation expense, less the gain on extinguishment of debt, net.

In evaluating EBITDA and Adjusted EBITDA, you should be aware that in the future we may incur expenses similar to the adjustments described above. Our presentation of EBITDA and Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by expenses that are unusual, non-routine, or non-recurring. EBITDA and Adjusted EBITDA have limitations as an analytical tool, and you should not consider it in

isolation, or as a substitute for analysis of our results as reported under GAAP. Some of these limitations are that it does reflect:

- cash expenditures for capital expenditures or contractual commitments;
- changes in, or cash requirements for, our working capital requirements;
- interest expense, or the cash requirements necessary to service interest or principal payments on our indebtedness;
- the cost or cash required to replace assets that are being depreciated or amortized; and
- the impact on our reported results of earnings or charges resulting from items accounted for in the GAAP measure from which EBITDA and Adjusted EBITDA is derived.

The following table presents data relating to EBITDA and Adjusted EBITDA, which are non-GAAP measures, for the periods indicated:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
	(\$ in thousands)			
	(Unaudited)			
Net income:	\$ 19,322	\$ 37,536	\$ 52,605	\$ 48,673
Plus EBITDA adjustments:				
Income tax expense (benefit)	450	290	800	660
Total interest expense	28,498	28,465	54,239	57,148
Depreciation expense	3,416	3,116	6,853	6,477
EBITDA	51,686	69,407	114,497	112,958
Store closing costs ⁽¹⁾	573	737	798	3,658
Legal settlement ⁽²⁾	—	—	—	7,600
Non-cash Compensation expense ⁽³⁾	562	562	1,125	1,125
Less: gain on extinguishment of debt, net ⁽⁴⁾	—	(24,805)	—	(31,559)
Adjusted EBITDA	\$ 52,821	\$ 45,901	\$ 116,420	\$ 93,782

(1) Store closing costs represent costs to close stores in 2008 and 2009 related to downsizing (and do not include stores closed in the normal course of business).

(2) Legal settlement represents cash paid in a legal settlement in 2009.

(3) Non-cash compensation expense related to an agreement directly between Mr. Garcia and Mr. Fidel (not between the Company and Mr. Fidel), which expires in June 2010.

(4) Gain on extinguishment of debt, is a result of repurchasing outstanding indebtedness during 2009 at a discount to par.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our financial instruments are exposed to market risk from changes in interest rates. We do not use financial instruments for trading purposes. We use fixed rate securities to manage risk. Our earnings are substantially affected by our net interest income, which is the difference between the income earned on interest-bearing assets and the interest paid on interest-bearing notes payable. Increases in market interest rates could have an adverse effect on profitability.

Our financial instruments consist primarily of fixed rate finance receivables and fixed and variable rate notes payable. Our finance receivables are classified as subprime loans and generally bear interest ranging from 3.6% to 29.9% or the maximum interest rate allowed in states that impose interest rate limits. At June 30, 2010, the remaining scheduled maturities on our finance receivables ranged from one to 65 months, with a weighted average remaining maturity of 40.2 months. The interest rates we charge our customers on finance receivables have not changed significantly as a result of fluctuations in market interest rates. We may increase the interest rates we charge in the future if market interest rates rise. The affordability of our customer's payment is an important component of

the structure of our transactions. Because of these affordability concerns for our customers and interest rate limits imposed by some states, we may not pass on the entire portion of future rate increases to our customers.

Approximately \$738.3 million of our total debt of \$1.0 billion at June 30, 2010, is fixed-rate collateralized asset-backed securities issued under our securitization program, PALP financings, portfolio residual financings, senior secured notes payable, senior unsecured notes payable, and other notes with a fixed interest rate. Our securitization program has historically allowed us to mitigate our interest rate risk by periodically replacing variable rate borrowings under our portfolio warehouse facility with fixed rate borrowings during the year.

The table below illustrates the impact that hypothetical changes in interest rates could have on our interest expense for the six months ended June 30, 2010 and the year ended December 31, 2009. We compute the impact on interest expense for the period by first computing the baseline interest expense on our debt with interest rate risk, which includes the variable rate revolving credit lines and the variable rate notes payable. We then determine interest expense based on each of the interest rate changes listed below and compare the results to the baseline interest expense. The table does not give effect to our fixed rate receivables and borrowings.

Change in Rates	Increase/(Decrease) in Interest Expense	
	Six Months Ended	Year Ended
	June, 2010	December 31, 2009
	(\$ in thousands)	
+200 basis points.....	\$ 1,963	\$ 6,498
+100 basis points.....	\$ 982	\$ 3,249
-100 basis points.....	\$ (982)	\$ (3,249)
-200 basis points.....	\$ (1,963)	\$ (6,498)

In computing the effect of hypothetical changes in interest expense, we have assumed that:

- interest rates used for the baseline and hypothetical net interest expense amounts are on a monthly basis and in effect for the entire month;
- interest for the period is calculated on monthly average debt balances during the applicable periods; and
- there is no change in average balance outstanding as a result of the interest rate changes.

Our sensitivity to interest rate changes could be significantly different if actual experience differs from the assumptions used to compute the estimates.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2010. In designing and evaluating the disclosure controls and procedures, our 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 no evaluation of controls and procedures can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Our management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of June 30, 2010, the end of the period covered by this quarterly report on Form 10-Q, to ensure that the information required to be disclosed by us in the reports that we file or submit, as if we were required to file or submit such reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosures. We will continue to review and document our disclosure controls and procedures on

an ongoing basis, and may from time to time make changes aimed at enhancing their effectiveness and to ensure that our systems evolve with our business.

Changes in Internal Control over Financial Reporting

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter ended June 30, 2010, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are involved in various claims and actions arising in the ordinary course of business. In the opinion of management, based on consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on us. We believe appropriate accruals have been made for the disposition of these matters. In accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, we established an accrual for a liability when it is both probable that the liability has been incurred and the amount of the loss can be reasonably estimated. These accruals are reviewed monthly and adjusted to reflect the impact of negotiations, settlements and payments, rulings, advice of legal counsel, and other information and events pertaining to a particular case. Legal expenses related to defense, negotiations, settlements, rulings, and advice of outside legal counsel are expensed as incurred.

In August 2008, we received a Civil Investigative Demand from the Office of Attorney General, Consumer Protection Division, asking for the production of certain materials. The demand indicates it is the subject of an investigation of possible violations of the Deceptive Trade Practices Act, Sections 17.46(a) and (b) in the marketing, advertising, financing, and selling of used cars. We provided the Texas Office of Attorney General with all requested information in August 2008. At that time, we met with the state's Attorney General's Office to provide them with an overview of us and discuss the requested materials. At the meeting, we agreed on some minor changes in the requested materials. In addition, the Attorney General's Office indicated that they would review the materials we provided to them and if there were any concerns they would contact us to meet, discuss and resolve the concerns. We will continue to fully cooperate with the state's Attorney General's Office in responding to the demand and any follow up discussions with them. The Texas Attorney General has requested additional information and documentation from time to time, most recently in February 2010 when it requested clarifying information limited to vehicle inspections, after sale repairs, warranty, loan servicing, and consumer concerns. We believe the request is routine in nature and we have responded accordingly. We believe we are in compliance with all applicable state laws and regulations and we intend to continue to cooperate with state officials. We believe we do not have any qualitative or quantitative loss contingencies related to this matter.

We are currently appealing to the Nevada Supreme Court an adverse administrative ruling on the efficacy of certain sales tax refunds we have requested for the 2002 and 2003 tax years. While only applicable to 2002 and 2003, an adverse ruling could affect subsequent tax years as well. In several of our states, we file for and receive sales tax refunds for sales taxes paid on retail installment sales of the amount related to that portion of the sales price ultimately not collected from our customers. Prior to this adverse ruling, the Department of Taxation of the State of Nevada had, in an audit of tax years 1998-2001, allowed such refunds. The Department is now taking the position that because the contracts are assigned to our related finance company (which they were in certain of our prior periods as well) we are not entitled to the refund. We are vigorously pursuing our rights to the refunds and believe we have a positive position and will prevail in this proceeding. Total sales tax refunds from 2002 through June 30, 2010 were \$4.9 million. We have not accrued any amounts with respect to this matter.

On June 9, 2009, a former customer filed a complaint in Los Angeles County Superior Court, alleging the post repossession notice sent to the former customer was materially defective and incomplete. The plaintiff brought the case as a purported class action in a representative capacity under California's Unfair Competition Law. The parties entered into negotiations and reached a settlement, which the court preliminarily approved on April 22, 2010. The

court subsequently granted final approval and we have paid the settlement in the second quarter of 2010. The amount was previously accrued at December 31, 2009 and was sufficient to cover the settlement.

Additionally, in the ordinary course of business, we are a defendant in various other types of legal proceedings. Although we cannot determine at this time the amount of the ultimate exposure from these lawsuits, if any, based on the advice of counsel management does not expect the final outcome to have a material adverse effect on us.

Item 1A. Risk Factors

In connection with information set forth in this quarterly report on Form 10-Q, the factors discussed under “Risk Factors” in our Offering Memorandum for our \$200.0 million 12.625% senior secured notes due 2017 dated May 27, 2010, should be considered. These risks could materially and adversely affect our business, financial condition, and results of operations. There have been no material changes to the factors discussed in our Offering Memorandum.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Recent sales of unregistered securities

None

Purchases of equity securities by the issuer and affiliated purchasers

None

Item 3. Defaults Upon Senior Securities

None

Item 4. Other Information

None

Item 5. Exhibits

Not Applicable

