Citron RESEARCH

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No other Citron story has generated as much reader interest over time as World Acceptance Corp. (NASDAQ:WRLD) Citron initially examined WRLD in May 2009, documenting how the company systematically abuses the economically disadvantaged with its egregious and downright sleazy lending tactics. The stock was $20, and the economy was on the ropes.

Citron thought the US government would inevitably intervene to protect consumers. Obviously, consumer protection has been slower than we expected. Today WRLD's book of sub-sub-sub-prime consumer loans has swollen to $1.1 billion, the stock perched at $90, and its day of reckoning may have just arrived.

An outstanding piece of journalism, just published by Pulitzer Prize winning ProPublica, which has no dog in the fight with regard to the stock or the market, has served up World Acceptance on a silver platter to the enforcers at the CFPB. They convincingly document how WRLD is engaged in systematic fraud by forcing unsuspecting customers to buy **credit insurance**.

Credit Insurance: the Triggering Event

The CFPB has already acted decisively against the deceptive sales practices of **credit insurance:** its first two enforcement actions were against credit card lenders Capital One and Discover -- over **exactly** the same issue.

It does not take much imagination to conclude that WRLD's days of jamming customers with credit insurance are about to come to an end.

Credit insurance is a huge driver of profits at WRLD, but just how much? Citron estimates that it could be as high as 50% of net income. In contrast to the large credit card issuers already sanctioned by CFPB, for whom credit insurance represents a small ladle of gravy, **more than half of WRLD's profits are likely to evaporate once the CFPB gets involved.** Citron challenges readers to identify another public company with more exposure to this sleazy product.

There are two components of profits from credit insurance:

1. WRLD directly books an insurance commission for placing the insurance with Life of the South (part of the public company Fortegra, ticker: FRF). Life of the South is WRLD's sole insurance partner. WRLD's last 10-K discloses insurance commission revenue of $47m. It is safe to assume that most or all of this revenue falls to the bottom line. After deducting WRLD's 37% tax rate, $30m, exactly 30% of WRLD's $101m net income flows right to the bottom line from credit insurance.

2. WRLD also lends to borrowers the extra money to pay the insurance premium, so it is earning interest income for financing the premium. Here we have to do a little algebra.

   We know from Fortegra's 10-K that it pays out a 64% commission rate – in other words, 64% of the insurance premiums it receives are paid out as commissions to lenders like WRLD. So, we can divide WRLD's commission revenue by the commission rate to back into the amount of premium it is financing: $47m of commissions divided by a 64% commission rate equals $74m in premiums. WRLD average interest rate on its loan portfolio is 64%. So, 64% multiplied by $74m in financed premium is $47m in interest income. After tax, that's $30m of net income, or another 30% of net income. So, that's how we estimate that WRLD earns more than half its net income from credit insurance.

Furthermore, ProPublica's investigation also illustrates how WRLD's loan portfolio is an uncollectable house of cards. WRLD systematically refinances delinquent borrowers in a large scale charade of "extend-and-pretend". According to ProPublica's reporting, 30% of loans are delinquent at the end of each month. Rather than book loan losses, WRLD continues to "flip" loans to these customers to "buy time." Somehow WRLD still reports that only 2.5% of its customers are delinquent.

WRLD trades at 12x earnings and 3x book value. Both earnings and book value are based on perpetuating fraudulent business practices, and the CFPB could pull the plug on WRLD anytime.

The Inside Scoop

While the regulatory threat gathers, insiders have sold $36m of stock in the last 3 years, $12m in the last 12 months, and $6m just this year, all while buying back stock to leverage the company and hit EPS targets.

The CEO has $9m of restricted stock that vests based on hitting EPS growth targets in the mid-teens % range. In the last two years, they have bought back $322m of stock and the increased debt by $213m. Last quarter net income grew by 1% but EPS grew by 19% because of the buybacks. They have to do buybacks to achieve their mid-teens EPS growth targets.

Pro Publica: The Entire Story

Without further adieu, read what we believe is a future award winning piece of journalism. Read all three parts and look at the attachments. The CFPB has been handed its roadmap:

http://www.propublica.org/article/installment-loans-world-finance http://www.marketplace.org/topics/wealth-poverty/beyond-payday-loans-installment-lending-and-cycle-debt/problem-behind-big

http://www.marketplace.org/topics/wealth-poverty/beyond-payday-loans-installment-lending-and-cycle-debt/lucrative-installment

US Geographic operations overview, with example loans:
http://projects.propublica.org/graphics/installment-loans

A typical World Finance loan contract:
http://www.propublica.org/documents/item/695366-katrina-1st-renewal

Conclusion

Consider the abject uncollectability of virtually all of WRLD's entire loan portfolio. Consider how World is financed by JP Morgan and Wells Fargo, who wouldn't think of putting in banks and extending normal bank lending to World's customer base. And consider half their revenue coming from an income boosting deception that two major credit card companies have already been clobbered over.

World Acceptance is a one-of-a-kind: a true sub-sub-sub-prime investment.