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FINANCIAL FEDERAL CORP
Form 10-Q
June 13, 2002

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the Quarter Ended April 30, 2002

Commission file number 1-12006

FINANCIAL FEDERAL CORPORATION
(Exact name of registrant as specified in its charter)

Nevada
(State of incorporation)

88-0244792
(I.R.S. Employer Identification Number)

733 Third Avenue, New York, NY 10017
(Address of principal executive offices)
(Zip code)

(212) 599-8000
(Registrant's 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 X No

At June 3, 2002, 16,769,774 shares of Registrant's common stock, \$.50 par value, were outstanding.

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FINANCIAL FEDERAL CORPORATION
AND SUBSIDIARIES

Quarterly Report on Form 10-Q
for the quarter ended April 30, 2002

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Effective June 6 2002, the Board of Directors of Financial Federal Corporation ("the Company") dismissed Arthur Andersen LLP ("Andersen") as the Company's independent auditors and appointed KPMG LLP as the Company's new independent auditors. The financial statements included in Item 1 herein have been reviewed by Andersen. Historically, it had not been the practice of the Company to obtain or Andersen to issue accountants' review reports in connection with such reviews. Accordingly, an accountants' review report was not issued at the time of completion of the aforementioned review. The audit team that performed the review is no longer employed by Andersen and, therefore, it is not possible for the Company to obtain such report.

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	April 30, 2002 *	Jul
	-----	-----
ASSETS		
Finance receivables	\$1,421,171	\$1,32
Allowance for possible losses	(23,582)	(2
	-----	-----
Finance receivables - net	1,397,589	1,29
Cash	9,183	1
Other assets	3,978	
	-----	-----
TOTAL ASSETS	\$1,410,750	\$1,31
	=====	=====
LIABILITIES		
Senior debt:		
Long-term	\$602,879	\$70
Short-term	399,266	22
Subordinated debt	93,478	9
Accrued interest, taxes and other liabilities	48,360	5
Deferred income taxes	29,887	2
	-----	-----
Total liabilities	1,173,870	1,10
	-----	-----
STOCKHOLDERS' EQUITY		
Preferred stock - \$1 par value, authorized 5,000,000 shares, none issued		
Common stock - \$.50 par value, authorized 100,000,000 shares; shares issued and outstanding (net of 136,961 treasury shares): 16,757,174 at April 30, 2002 and 16,540,329 at July 31, 2001	8,379	
Additional paid-in capital	65,821	6
Retained earnings	162,680	13
	-----	-----
Total stockholders' equity	236,880	20
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$1,410,750	\$1,31
	=====	=====

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FINANCIAL FEDERAL CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
AND RETAINED EARNINGS *

(Dollars in Thousands, Except Per Share Amounts)

	Three Months Ended		Nine Months	
	April 30,		Apri	
	-----	-----	-----	-----
	2002	2001	2002	
	-----	-----	-----	-----
Finance income	\$34,188	\$34,825	\$103,410	\$10

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Interest expense	11,852	15,886	38,485	4
	-----	-----	-----	---
Net finance income before provision for possible losses on finance receivables	22,336	18,939	64,925	5
Provision for possible losses on finance receivables	1,400	1,300	4,025	
	-----	-----	-----	---
Net finance income	20,936	17,639	60,900	5
Salaries and other expenses	5,414	4,517	15,609	1
	-----	-----	-----	---
Earnings before income taxes	15,522	13,122	45,291	3
Provision for income taxes	6,116	5,112	17,831	1
	-----	-----	-----	---
NET EARNINGS	9,406	8,010	27,460	2
Retained earnings - beginning of period	153,274	118,606	135,220	10
Acquisition of treasury shares	--	--	--	(
	-----	-----	-----	---
RETAINED EARNINGS - END OF PERIOD	\$162,680	\$126,616	\$162,680	\$12
	=====	=====	=====	===
EARNINGS PER COMMON SHARE:				
Diluted	\$0.50	\$0.44	\$1.48	
	=====	=====	=====	---
Basic	\$0.56	\$0.49	\$1.65	
	=====	=====	=====	---

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FINANCIAL FEDERAL CORPORATION
AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS *
(Dollars in Thousands)

Nine Months Ended April 30,		2002	
	-----	-----	---
Cash flows from operating activities:			
Net earnings		\$27,460	\$2
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Provision for possible losses on finance receivables		4,025	
Depreciation and amortization		9,854	
Deferred income taxes		800	
Decrease (increase) in other assets		145	
Decrease in accrued interest, taxes and other liabilities		(4,722)	(
		-----	---
Net cash provided by operating activities		37,562	3
		-----	---
Cash flows from investing activities:			
Finance receivables:			
Originated		(604,587)	(53
Collected		493,517	38
Other		(323)	

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	-----	-----
Net cash used in investing activities	(111,393)	(15)
	-----	-----
Cash flows from financing activities:		
Commercial paper:		
Maturities 90 days or less (net)	61,402	(19)
Maturities greater than 90 days:		
Proceeds	43,712	12
Repayments	(43,232)	(11)
Bank borrowings - net proceeds (repayments)	(38,060)	22
Proceeds from asset securitization financing	100,000	
Proceeds from senior term notes	5,000	12
Repayments of senior term notes	(55,000)	(3)
Variable rate senior notes - net repayments	(3,275)	(
Proceeds from exercise of stock options	2,079	
Proceeds from exercise of warrants	--	
Other	137	
	-----	-----
Net cash provided by financing activities	72,763	12
	-----	-----
NET (DECREASE) INCREASE IN CASH	(1,068)	
Cash - beginning of period	10,251	
	-----	-----
CASH - END OF PERIOD	\$9,183	\$1
	=====	=====
Supplemental disclosures of cash flow information:		
Interest paid	\$38,882	\$4
	=====	=====
Income taxes paid	\$16,604	\$1
	=====	=====

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FINANCIAL FEDERAL CORPORATION
AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

In the opinion of the management of Financial Federal Corporation and Subsidiaries (the "Company"), the accompanying unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring items) necessary to present fairly the financial position at April 30, 2002 and the results of operations and cash flows of the Company for the three and nine month periods ended April 30, 2002 and 2001. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and note disclosures included in the Company's Annual Report on Form 10-K for the fiscal year ended July 31, 2001. The consolidated results of operations for the three and nine month periods ended April 30, 2002 and 2001 are not necessarily indicative of the results for the respective full years.

NOTE 2 - DESCRIPTION OF BUSINESS

The Company is an independent financial services company providing collateralized lending, financing and leasing services nationwide to primarily middle-market commercial enterprises in the general construction, road and infrastructure construction and repair, manufacturing, road transportation and

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waste disposal industries. The Company lends against, finances and leases a wide range of revenue-producing equipment such as cranes, earth movers, machine tools, personnel lifts, trailers and trucks.

NOTE 3 - EARNINGS PER COMMON SHARE

Earnings per common share was calculated as follows (in thousands, except per share amounts):

	Three months ended April 30,		Nine months ended April 30,	
	2002	2001	2002	2001
Net earnings (used for basic earnings per share)	\$9,406	\$8,010	\$27,460	\$23,012
Effect of convertible securities	710	707	2,168	2,160
Adjusted net earnings (used for diluted earnings per share)	\$10,116	\$8,717	\$29,628	\$25,172
Weighted average common shares outstanding (used for basic earnings per share)	16,674	16,466	16,610	15,686
Effect of dilutive securities:				
Convertible notes	3,024	3,024	3,024	3,024
Stock options and restricted stock	489	333	419	281
Warrants	--	--	--	725
Adjusted weighted average common shares and assumed conversions (used for diluted earnings per share)	20,187	19,823	20,053	19,716
Net earnings per common share - Diluted	\$0.50	\$0.44	\$1.48	\$1.28
Net earnings per common share - Basic	\$0.56	\$0.49	\$1.65	\$1.47

NOTE 4 - SENIOR DEBT

At April 30, 2002, the Company had \$370.0 million of committed unsecured revolving credit facilities with various banks including \$195.0 million that expire after April 30, 2003 and \$175.0 million that expire before April 30, 2003. Long-term senior debt of \$602.9 million at April 30, 2002 comprised \$280.0 million of term notes payable, \$78.0 million of borrowings under credit facilities that expire after April 30, 2003, \$28.0 million of borrowings under

credit facilities that expire before April 30, 2003 and \$89.0 million of commercial paper that were supported by credit facilities that expire after April 30, 2003 and \$127.9 million of the asset securitization financings.

In December 2001, the Company completed its second asset securitization financing transaction obtaining proceeds of \$100.0 million. At April 30, 2002, the Company had \$225.0 million of asset securitization financings

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accounted for as secured borrowings that were included in senior debt in the accompanying Consolidated Balance Sheet. The terms of both of the Company's securitizations provide for committed revolving financing for a one year term that, if not renewed prior to the current expiration date in December 2002, can be converted into term debt at the Company's option. At April 30, 2002, finance receivables in the accompanying Consolidated Balance Sheet included \$258.8 million of securitized receivables.

NOTE 5 - STOCKHOLDERS' EQUITY

In March 2002, the Company awarded 545,000 shares of restricted stock to certain of its senior officers. The shares vest ratably over eight years from the date granted.

PART I

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS OF OPERATIONS

Comparison of three months ended April 30, 2002 to three months ended April 30 2001

Finance income decreased by 2% to \$34.2 million in the third quarter of fiscal 2002 from \$34.8 million in the third quarter of fiscal 2001. The decrease was primarily due to the decrease in the net yield of the Company's finance receivables as a result of the sharp decline in market interest rates since May 2001 and, to a lesser extent, an increase in the level of non-performing assets in the third quarter of fiscal 2002 from the third quarter of fiscal 2001, offset by the 11%, or \$144 million, increase in average finance receivables outstanding to \$1.407 billion in the third quarter of fiscal 2002 from \$1.263 billion in the third quarter of fiscal 2001. Finance receivables booked in the third quarter of fiscal 2002 and fiscal 2001 were \$208 million and \$190 million, respectively.

Interest expense, incurred on borrowings used to fund finance receivables, decreased by 25% to \$11.9 million in the third quarter of fiscal 2002 from \$15.9 million in the third quarter of fiscal 2001. The decrease was primarily due to the decrease in the Company's weighted average cost of borrowed funds as a result of significantly lower average market interest rates in the third quarter of fiscal 2002 as compared to the third quarter of fiscal 2001, partially offset by the 10% increase in average debt outstanding in the third quarter of fiscal 2002 from the third quarter of fiscal 2001.

Net finance income before provision for possible losses on finance receivables increased by 18% to \$22.3 million in the third quarter of fiscal 2002 from \$18.9 million in the third quarter of fiscal 2001. Net finance income before provision for possible losses expressed as an annualized percentage of average finance receivables outstanding ("net interest margin") increased to 6.5% in the third quarter of fiscal 2002 from 6.2% in the third quarter of fiscal 2001. The increase was primarily due to the decline in market interest rates from May 2001 since the Company's debt reprices faster than the Company's finance receivables.

The provision for possible losses on finance receivables increased by 8% to \$1.4 million in the third quarter of fiscal 2002 from \$1.3 million in the third quarter of fiscal 2001. The provision for possible losses is determined

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by the amount required to increase the allowance for possible losses to a level that management considers appropriate. The allowance for possible losses was \$23.6 million, or 1.66% of finance receivables at April 30, 2002, compared to \$21.9 million, or 1.66% of finance receivables, at July 31, 2001 and \$21.2 million, or 1.66% of finance receivables, at April 30, 2001. The allowance is periodically reviewed by the Company's management and is estimated based on total finance receivables, net credit losses incurred and management's current assessments of the risks inherent in the Company's finance receivables from national and regional economic conditions, industry conditions,

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concentrations, the financial condition of counterparties and other factors. The level of the allowance may need to be increased due to unexpected changes in these factors.

Net credit losses (write-downs of finance receivables less subsequent recoveries) were \$841,000 and \$586,000 in the third quarter of fiscal 2002 and 2001, respectively. Net credit losses expressed as an annualized percentage of average finance receivables outstanding ("loss ratio") were 0.24% and 0.19% in the third quarter of fiscal 2002 and 2001, respectively. Non-performing assets (includes finance receivables classified as non-accrual and assets received to satisfy finance receivables) were \$49.5 million, or 3.5% of total finance receivables, at April 30, 2002, compared to \$34.4 million, or 2.6% of total finance receivables, at July 31, 2001 and \$28.8 million, or 2.2% of total finance receivables, at April 30, 2001. Delinquent finance receivables (transactions with a contractual payment more than 60 days past due) were \$42.3 million, or 3.0% of total finance receivables, at April 30, 2002, compared to \$24.8 million, or 1.9% of total finance receivables, at July 31, 2001 and \$29.4 million, or 2.3% of total finance receivables, at April 30, 2001. Although the Company's non-performing assets, delinquent finance receivables and net credit losses have increased, and could continue to increase, their current and expected levels are below historical and current industry standards.

Salaries and other expenses increased by 20% to \$5.4 million in the third quarter of fiscal 2002 from \$4.5 million in the third quarter of fiscal 2001. The increase was primarily due to the increase in the number of marketing and administrative employees, salary increases and additional costs incurred from the increased number of problem accounts in the third quarter of fiscal 2002 as compared to the third quarter of fiscal 2001.

Net earnings increased by 17% to \$9.4 million in the third quarter of fiscal 2002 from \$8.0 million in the third quarter of fiscal 2001. Diluted earnings per share increased by 14% to \$0.50 per share in the third quarter of fiscal 2002 from \$0.44 per share in the third quarter of fiscal 2001 and basic earnings per share increased by 14% to \$0.56 per share in the third quarter of fiscal 2002 from \$0.49 per share in the third quarter of fiscal 2001. The percentage increase in diluted earnings per share was lower than the percentage increase in net earnings primarily due to the effect that the convertible notes had on the diluted earnings per share calculation and the 25% increase in the average price of the Company's common stock in the third quarter of fiscal 2002 from the third quarter of fiscal 2001. The percentage increase in basic earnings per share was lower than the percentage increase in net earnings primarily due to rounding and an increase in the number of shares of the Company's outstanding common stock in the third quarter of fiscal 2002 from the third quarter of fiscal 2001 from stock option exercises.

Comparison of nine months ended April 30, 2002 to nine months ended April 30, 2001

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Finance income increased by 1% to \$103.4 million in the first nine months of fiscal 2002 from \$102.7 million in the first nine months of fiscal 2001. The increase was primarily due to the 13%, or \$152 million, increase in average finance receivables outstanding to \$1.366 billion in the first nine months of fiscal 2002 from \$1.214 billion in the first nine months of fiscal 2001 offset by the decrease in the net yield of the Company's finance receivables as a result of the sharp decline in market interest rates since January 2001 and, to a lesser extent, an increase in the level of non-performing assets in the first nine months of fiscal 2002 from the first nine months of fiscal 2001. Finance receivables booked in the first nine months of fiscal 2002 and fiscal 2001 were \$605 million and \$533 million, respectively.

Interest expense, incurred on borrowings used to fund finance receivables, decreased by 21% to \$38.5 million in the first nine months of fiscal 2002 from \$49.0 million in the first nine months of fiscal 2001. The decrease was primarily due to the decrease in the Company's weighted average cost of borrowed funds as a result of significantly lower average market interest rates in the first nine months of fiscal 2002 as compared to the first nine months of fiscal 2001, partially offset by the 11% increase in average debt outstanding in the first nine months of fiscal 2002 from the first nine months of fiscal 2001.

Net finance income before provision for possible losses on finance receivables increased by 21% to \$64.9 million in the first nine months of fiscal 2002 from \$53.7 million in the first nine months of fiscal 2001. The net interest margin was 6.4% in the first nine months of fiscal 2002 compared to 5.9% in the first nine months of fiscal 2001. The increase was primarily due to the decline in market interest rates from January 2001 since the Company's debt reprices faster than the Company's finance receivables.

The provision for possible losses on finance receivables increased by 13% to \$4.0 million in the first nine months of fiscal 2002 from \$3.6 million in the first nine months of fiscal 2001. Net credit losses were \$2.4 million and

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\$1.4 million in the first nine months of fiscal 2002 and 2001, respectively. The loss ratio was 0.23% and 0.16% in the first nine months of fiscal 2002 and 2001, respectively.

Salaries and other expenses increased by 25% to \$15.6 million in the first nine months of fiscal 2002 from \$12.5 million in the first nine months of fiscal 2001. The increase was primarily due to the increase in the number of marketing and administrative employees, salary increases and additional costs incurred from the increased number of problem accounts in the first nine months of fiscal 2002 as compared to the first nine months of fiscal 2001.

Net earnings increased by 19% to \$27.5 million in the first nine months of fiscal 2002 from \$23.0 million in the first nine months of fiscal 2001. Diluted earnings per share increased by 16% to \$1.48 per share in the first nine months of fiscal 2002 from \$1.28 per share in the first nine months of fiscal 2001 and basic earnings per share increased by 12% to \$1.65 per share in the first nine months of fiscal 2002 from \$1.47 per share in the first nine months of fiscal 2001. The percentage increase in diluted earnings per share was lower than the percentage increase in net earnings primarily due to the effect that the convertible notes had on the diluted earnings per share calculation and the 22% increase in the average price of the Company's common stock in the first nine months of fiscal 2002 from the first nine months of fiscal 2001. The percentage increase in basic earnings per share was lower than the percentage increase in net earnings primarily due to the increase in

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the number of outstanding shares of the Company's common stock resulting from the exercise of 1.6 million warrants in the second quarter of fiscal 2001.

LIQUIDITY AND CAPITAL RESOURCES

The Company's operations and growth are dependent upon the continued availability of funds that are needed to originate or acquire finance receivables and to purchase portfolios of finance receivables. The Company may obtain required funds from a variety of sources, including operating cash flow, dealer placed and directly issued commercial paper, borrowings under committed unsecured revolving credit facilities, private and public issuances of term debt, conduit and term securitizations of finance receivables and sales of common and preferred equity. Management believes that the Company's sources of liquidity are well diversified. As such, the Company is not dependent on any single funding source or on any single credit provider. Management believes, but cannot assure, that sufficient liquidity is available to the Company to support its future operations and growth.

The Company's commercial paper is rated "F-2" by Fitch, Inc. ("Fitch") and the Company's senior term notes are rated "BBB" by Fitch. These credit ratings provide the Company with greater access to capital markets. Fitch has recently reported that its ratings outlook for the Company is stable.

The Company issues investment grade commercial paper directly and through a \$350.0 million program with recognized dealers. Commercial paper outstanding at April 30, 2002 was \$205.7 million. The Company's commercial paper is unsecured and matures within 270 days. Increases in commercial paper are generally offset by decreases in bank and other borrowings, and vice versa. The Company's current policy is to maintain committed revolving credit facilities from banks so that the aggregate amount available thereunder exceeds commercial paper outstanding.

At April 30, 2002, the Company had \$370.0 million of committed unsecured revolving credit facilities with various banks including \$195.0 million that expire after one year and \$175.0 million that expire within one year. At April 30, 2002, the Company had \$78.0 million of borrowings outstanding under credit facilities expiring after one year and \$28.0 million of borrowings outstanding under credit facilities expiring within one year.

In December 2001, the Company completed its second asset securitization financing transaction obtaining proceeds of \$100.0 million. The Company used the proceeds to repay borrowings under bank credit facilities. At April 30, 2002, the Company had \$225.0 million of asset securitization financings accounted for as secured borrowings that were included in senior debt in the accompanying Consolidated Balance Sheet. The terms of both of the Company's securitizations provide for committed revolving financing for a one year term that, if not renewed prior to the current expiration date in December 2002, can be converted into term debt at the Company's option.

In September 2001, the Company repaid \$55.0 million of term debt at maturity with the proceeds from additional borrowings under bank credit facilities.

FORWARD-LOOKING STATEMENTS

Certain statements in this document may include the words or phrases "can be," "expects," "may affect," "may depend," "believe," "estimate," "intend," "could," and similar words and phrases that constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933

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and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are subject to various known and unknown risks and uncertainties and the Company cautions you that any forward-looking information provided by or on its behalf is not a guarantee of future performance. The Company's actual results could differ materially from those anticipated by such forward-looking statements due to a number of factors, some of which are beyond the Company's control, including, without limitation, (i) the ability to obtain funding on acceptable terms, (ii) changes in the risks inherent in the Company's receivables portfolio and the adequacy of the Company's reserves, (iii) changes in market interest rates, (iv) changes in economic, financial, and market conditions, (v) changes in competitive conditions and (vi) the loss of key executives or other personnel. Forward-looking statements apply only as of the date made and the Company is not required to update forward-looking statements for subsequent or unanticipated events or circumstances.

PART II

Item 6

EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

- 10.30 Form of Restricted Stock Agreement between the Registrant and its Chief Executive Officer
- 10.31 Form of Restricted Stock Agreement between the Registrant and certain of its senior officers

(b) Reports on Form 8-K

The Company filed on a report on Form 8-K dated June 6, 2002 reporting, under Item 4, the announcement of the appointment of KPMG LLP as the Company's independent auditors.

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SIGNATURES

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

FINANCIAL FEDERAL CORPORATION

(Registrant)

By: /s/ Steven F. Groth

Senior Vice President and
Chief Financial Officer
(Principal Financial Officer)

By: /s/ David H. Hamm

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Vice President and Controller
(Principal Accounting Officer)

June 13, 2002

(Date)

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INDEX TO EXHIBITS

Exhibit No.	Exhibits
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