MICROFINANCIAL INC
Form 10-Q
August 14, 2002

FORM 10-Q
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES AND EXCHANGE ACT OF 1934
For the Quarterly Period Ended June 30, 2002

OR

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

Commission File No. 1-14771

MICROFINANCIAL INCORPORATED
(Exact name of Registrant as specified in its Charter)

Massachusetts	04-2962824
(State or other jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

950 Winter Street, Waltham, MA 02451
(Address of Principal Executive Offices)

(781) 890-0177
(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(b) of the Securities and 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. [X] Yes [ ] No

As of August 9, 2002, 12,821,946 shares of the registrant's common stock were outstanding.

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MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)
(Unaudited)

	December 31, 2001	June 30, 2002
ASSETS		
Net investment in leases and loans:		
Receivables due in installments	$ 399,361	$ 383,481
Estimated residual value	37,114	36,603
Initial direct costs	7,090	6,569
Loans receivable	2,248	2,028
Less:		
Advance lease payments and deposits	(287)	(254)
Unearned income	(104,538)	(94,466)
Allowance for credit losses	(45,026)	(40,829)
Net investment in leases and loans	$ 295,962	$ 293,132
Investment in service contracts	14,126	15,475
Cash and cash equivalents	20,645	21,517
Property and equipment, net	16,034	13,225
Other assets	14,961	15,744
Total assets	$ 361,728	$ 359,093
LIABILITIES AND STOCKHOLDERS' EQUITY		
Notes payable	$ 203,053	$ 196,045
Subordinated notes payable	3,262	3,262
Capitalized lease obligations	833	695
Accounts payable	2,517	2,540
Dividends payable	642	641
Other liabilities	6,182	6,542
Income taxes payable	4,211	1,699
Deferred income taxes payable	30,472	33,173
Total liabilities	251,172	244,597
Commitments and contingencies	--	--
Stockholders' equity:		

Preferred stock, $.01 par value; 5,000,000 shares authorized; no shares issued at 12/31/01 and 6/30/02	--	--
Common stock, $.01 par value; 25,000,000 shares authorized; 13,410,646 shares issued at 12/31/01 and 6/30/02	134	134
Additional paid-in capital	47,723	47,740
Retained earnings	69,110	73,000
Treasury stock (588,700 shares of common stock at 12/31/01, 588,700 shares of common stock at 6/30/02), at cost	(6,343)	(6,343)
Notes receivable from officers and employees	(68)	(35)
Total stockholders' equity	110,556	114,496
Total liabilities and stockholders' equity	$ 361,728	$ 359,093

The accompanying notes are an integral part of the condensed consolidated financial statements.

MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(Unaudited)

	For the three months ended June 30,		For the six months end June 30,	
	2001	2002	2001	2002
Revenues:				
Income on financing leases and loans	$ 18,060	$ 13,791	$ 36,791	$ 29,
Income on service contracts	2,099	2,458	4,234	4,
Rental income	9,252	9,220	18,387	19,
Loss and damage waiver fees	1,568	1,532	3,148	3,
Service fees and other	7,572	5,960	15,335	12,
Total revenues	38,551	32,961	77,895	68,
Expenses:				
Selling general and administrative	10,658	11,409	22,563	23,
Provision for credit losses	11,819	10,824	22,085	21,
Depreciation and amortization	3,640	4,851	7,083	8,
Interest	3,493	2,618	7,862	5,
Total expenses	29,610	29,702	59,593	59,
Income before provision for income taxes	8,941	3,259	18,302	8,
Provision for income taxes	3,762	1,304	7,704	3,
Net income	$ 5,179	$ 1,955	$ 10,598	$ 5,

Net income per common share -- basic	$ 0.41	$ 0.15	$ 0.83	$ 0
Net income per common share -- diluted	$ 0.40	$ 0.15	$ 0.82	$ 0
Weighted-average shares used to compute:				
Basic net income per share	12,759,548	12,821,946	12,750,299	12,821,
Fully diluted net income per share	12,981,450	12,901,149	12,933,339	12,877,

The accompanying notes are an integral part of the condensed consolidated financial statements.

MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	For the three months ended June 30,		For the
	2001	2002	2001
Cash flows from operating activities:			
Cash received from customers	$ 47,500	$ 45,003	$ 95,12
Cash paid to suppliers and employees	(11,683)	(10,149)	(20,96
Cash paid for income taxes	(4,572)	(2,270)	(4,70
Interest paid	(3,605)	(2,579)	(8,04
Interest received	365	87	76
Net cash provided by operating activities	28,005	30,092	62,17
Cash flows from investing activities:			
Investment in lease contracts	(24,813)	(23,358)	(48,65
Investment in inventory	(1,740)	(1,057)	(2,49
Investment in direct costs	(1,399)	(1,417)	(2,88
Investment in service contracts	(1,631)	(2,081)	(2,95
Investment in Resource Leasing Corporation	0	0	(6,90
Investment in fixed assets	(432)	19	(85
Repayment of notes from officers	0	23	
Investment in notes receivable	(24)	0	(4
Repayment of notes receivable	2	0	
Net cash used in investing activities	(30,037)	(27,871)	(64,78
Cash flows from financing activities:			
Proceeds from secured debt	22,473	11,929	57,85
Repayment of secured debt	(22,565)	(13,733)	(53,68

Proceeds from refinancing of secured debt	104,500	90,000	209,00
Prepayment of secured debt	(104,500)	(90,000)	(209,00
Proceeds from short term demand notes payable	889	0	88
Repayment of short term demand notes payable	(75)	(200)	(7
Proceeds from issuance of subordinated debt	1,075	0	2,87
Repayment of subordinated debt	0	0	(3,00
Proceeds from exercise of common stock options	529	0	52
Repayment of capital leases	(116)	(105)	(25
Payment of dividends	(574)	(641)	(1,14
Net cash provided by (used in) financing activities	1,636	(2,750)	3,97
Net (decrease) increase in cash and cash equivalents:	(396)	(529)	1,37
Cash and cash equivalents, beginning of period	19,729	22,046	17,95
Cash and cash equivalents, end of period	$ 19,333	$ 21,517	$ 19,33

(continued on following page)

The accompanying notes are an integral part of the condensed consolidated financial statements.

MICROFINANCIAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Continued)
(Unaudited)

	For the three months ended June 30,		For the six June
	2001	2002	2001
Reconciliation of net income to net cash provided by operating activities:			
Net income	$ 5,179	$ 1,955	$ 10,598
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	3,640	4,851	7,083
Provision for credit losses	11,819	10,824	22,085
Recovery of equipment cost and residual value, net of revenue recognized	8,779	13,367	18,795
Decrease in current taxes	(1,647)	(1,523)	(1,767)
Increase in deferred income taxes	837	557	4,776
Change in assets and liabilities:			
Decrease (increase) in other assets	(9)	502	92
Increase (decrease) in accounts payable	(683)	39	(518)
Increase (decrease) in accrued liabilities	90	(480)	1,035
Net cash provided by operating activities	$ 28,005	$ 30,092	$ 62,179

Supplemental disclosure of noncash activities:			
Property acquired under capital leases	$ 0	$ 68	$ 341
Accrual of common stock dividends	$ 640	$ 641	$ 640

(Concluded)

The accompanying notes are an integral part of the condensed consolidated financial statements.

MICROFINANCIAL INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(tables in thousands, except share and per share data)
(Unaudited)

(A) Nature of Business:

MicroFinancial Incorporated (the "Company") which operates primarily through its wholly-owned subsidiary, Leasecomm Corporation, is a specialized commercial finance company that primarily leases and rents "microticket" equipment and provides other financing services in amounts generally ranging from $400 to $3,000 with an average amount financed of approximately $1,400 and an average lease term of 44 months. The Company does not market its services directly to lessees but sources leasing transactions through a network of independent sales organizations and other dealer-based origination networks nationwide. The Company funds its operations primarily through borrowings under its credit facilities, issuances of subordinated debt and on balance sheet securitizations.

(B) Summary of Significant Accounting Policies:

Basis of Presentation:

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission for interim financial statements. Accordingly, the interim statements do not include all of the information and disclosures required for the annual financial statements. In the opinion of the Company's management, the condensed consolidated financial statements contain all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation of these interim results. These financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report and Form 10-K for the year ended December 31, 2001. The results for the six-month period ended June 30, 2002 are not necessarily indicative of the results that may be expected for the full year ended December 31, 2002.

The balance sheet at December 31, 2001 has been derived from the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

Allowance for Credit Losses:

The Company maintains an allowance for estimated credit losses on its investment in leases, loans, rental contracts and service contracts at an amount that it believes is sufficient to provide an adequate provision against losses in its portfolio. The allowance is determined principally on the basis of the historical loss experience of the Company and the level of recourse provided by such leases, loans and service contracts, if any. In addition, the allowance reflects management's judgment of the additional loss potential considering current economic conditions and the nature and characteristics of the underlying lease portfolio. The Company determines the necessary periodic provision for the credit losses taking into account actual and expected losses in the portfolio as a whole and the relationship of the allowance to the net investment in leases, loans, rental contracts and service contracts.

The following table sets forth the Company's allowance for credit losses as of December 31, 2001 and June 30, 2002 and the related provision, charge-offs and recoveries for the year ended December 31, 2001 and the six months ended June 30, 2002.

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MICROFINANCIAL INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(tables in thousands, except share and per share data)
(Unaudited)

Balance of allowance for credit losses at December 31, 2001		$45,026
Provision for credit losses	21,788	
Total provisions for credit losses		21,788
Charge-offs	32,562	
Recoveries	6,577	
Charge-offs, net of recoveries		25,985
Balance of allowance for credit losses at June 30, 2002		$ 40,829

At December 31, 2001 and June 30, 2002, other assets included prepayments and deposits of $4,809,000 and $3,891,000, respectively, and receivables totaling $10,553,000 and $11,855,000, respectively.

Earnings Per Share:

Basic net income per common share is computed based upon the weighted-average number of common shares outstanding during the period. Dilutive net income per common share gives effect to all dilutive potential common shares outstanding during the period. The computation of dilutive earnings per share does not assume the issuance of common shares that have an antidulitive effect on the net income per share. Options to purchase 40,609 and 1,770,000 shares of common stock were not included in the computation of diluted earnings per share for the three months ended June 30, 2001 and 2002 respectively because their effects were antidilutive. Options to purchase 449,847 and 1,770,000 shares of common stock were not included in the computation of diluted earnings per share for the six months ended June 30, 2001 and 2002 respectively because their effects were antidilutive.

	For three months ended June 30,	For six months ende June 30,

	2001	2002	2001	20
Net Income	$ 5,179	$ 1,955	$ 10,598	$
Shares used in computation:				
Weighted average common shares outstanding used in computation of net income per common share	12,759,548	12,821,946	12,750,299	12,8
Dilutive effect of common stock options	221,902	79,203	183,040	
Shares used in computation of net income per common share -- assuming dilution	12,981,450	12,901,149	12,933,339	12,8
Net income per common share	$ 0.41	$ 0.15	$ 0.83	$
Net income per common share assuming dilution	$ 0.40	$ 0.15	$ 0.82	$

MICROFINANCIAL INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Notes Payable:

On December 21, 1999, the Company entered into a revolving line of credit and term loan facility with a group of financial institutions whereby it may borrow a maximum of $150,000,000 based upon qualified lease receivables, loans, rentals and service contracts. On August 22, 2000, the revolving line of credit and term loan facility was amended and restated where by the Company may now borrow a maximum of $192,000,000 based upon qualified lease receivables, loans, rentals and service contracts. Outstanding borrowings with respect to the revolving line of credit bear interest based at Prime minus 0.25% for Prime Rate Loans, the prevailing rate per annum as offered in the London Interbank Offered Rate ("LIBOR") plus 1.75% for LIBOR Loans or the seven-day Money Market rate plus 2.00% for Swing Line advances. If the LIBOR Loans are not renewed upon their maturity they automatically convert into prime rate loans. Swing Line advances have a seven-day maturity and upon their maturity they automatically convert into prime rate loans. In addition, the Company's aggregate outstanding principal amount of Swing Line advances shall not exceed $10 million. The prime rate at December 31, 2001, and June 30, 2002 was 4.75%. The 90-day LIBOR rates December 31, 2001, and June 30, 2002 were 1.9380% and 1.8750%, respectively. The 7-day Money Market rates December 31, 2001, and June 30, 2002 were 1.88% and 1.87%, respectively.

The Company had borrowings outstanding under these agreements with the following terms:

	December 31, 2001		June 30, 2002	
Type	Rate	Amount	Rate	Amount
		(in thousands)		(in thousands)

Prime	4.5000%	$ 4,640	4.5000%	$ 15,869
LIBOR	3.8750%	100,000	3.6563%	30,000
LIBOR			3.7625%	30,000
LIBOR			3.7500%	50,000
Total Outstanding		$104,640		$125,869

Outstanding borrowings are collateralized by leases, loans, rentals and service contracts pledged specifically to the financial institutions. Management is currently negotiating the terms and conditions under which both parties would agree to renew the credit facility. To the extent the existing line of credit is not renewed and no event of default exists, the credit facility will be automatically converted to a term loan on September 30, 2002. All converted term loans are payable over the term of the underlying leases, loans, rentals and service contracts, but in any event not to exceed 36 monthly installments. The most restrictive covenants of the agreement have minimum net worth and income requirements.

MFI I has three series of notes outstanding, the 2000-1 Notes, the 2000-2 Notes, and the 2001-3 Notes. In March 2000, MFI I issued the 2000-1 Notes in aggregate principal amount of $50,056,686. In December 2000, MFI I issued the 2000-2 Notes in aggregate principal amount of $50,561,633. In September 2001, MFI I issued the 2001-3 Notes in aggregate principal amount of $39,397,354. Outstanding borrowings are collateralized by a specific pool of lease receivables. In September 2001, MFI II, LLC was formed and issued one series of notes, the 2001-1 Notes in aggregate principal amount of $10,000,000. Outstanding borrowings are collateralized by a specific pool of lease receivables as well as the excess cash flow from the MFI I collateral. These notes are subordinate to the three series of notes issued by MFI I.

At December 31, 2001 and June 30, 2002, MFI I and MFI II had borrowings outstanding under the series of notes with the following terms:

	December 31, 2001		June 30, 2002	
Series	Rate	Amount	Rate	Amount
		(in thousands)		(in thousands)
MFI I				
2000-1 Notes	7.3750%	19,855	7.3750%	12,005
2000-2 Notes	6.9390%	34,518	6.9390%	26,258
2001-3 Notes	5.5800%	34,160	5.5800%	24,868
MFI II LLC				
2001-1 Notes	8.0000%	8,725	8.0000%	6,175

Total Outstanding	$97,258	$69,306
	=======	=======

At December 31, 2001 and June 30, 2002, the Company also had other notes payable which totaled $1,155,000 and $870,000 respectively. Of these notes, at December 2001 and June 30, 2002, $339,000 and $54,000, respectively, are notes that are due on demand and bear interest at a rate of prime less 1.00%. At December 31, 2001 and June 30, 2002, the Company also had $816,000 of notes which were borrowed against the cash surrender value of the life insurance policies held on key officers. The interest rates on these loans range from 5.05% to 8.00%.

Stock Options:

Under the 1998 Equity Incentive Plan (the "1998 Plan") which was adopted on July 9, 1998 the Company had reserved 4,120,380 shares of the Company's common stock for issuance pursuant to the 1998 Plan. The Company granted a total of 520,000 options and a total of 211,000 options were surrendered during the six months ended June 30, 2002. A total of 2,245,000 options were outstanding at June 30, 2002 of which 716,400 were vested.

Dividends:

On June 17, 2002 the Company's Board of Directors approved a dividend of $.050 per common share for all outstanding common shares as of June 28, 2002 which was paid on July 15, 2002.

New Accounting Pronouncements:

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 142, "Goodwill and Other Intangible Assets". This Statement supersedes APB Opinion No. 17, "Intangible Assets" and addresses financial accounting and reporting for intangible assets, but not those acquired in a business combination at acquisition. SFAS No. 142 addresses financial accounting and reporting of goodwill and other intangible assets subsequent to their acquisition, assigning a definite or indefinite useful life to these assets. Goodwill and other intangible assets having an indefinite useful life will not be amortized, but rather tested at least annually for impairment. It also provides guidance on how to define, measure and record impairment losses on goodwill and other intangible assets and provides for additional disclosures regarding these assets in years subsequent to their acquisition. The provisions for this Statement are required to be applied for fiscal years beginning after December 15, 2001, although earlier adoption is permitted. The Company has determined that the adoption of this Statement does not have a material impact on its results of operations or consolidated financial position.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 provides new accounting standards for recording of liabilities related to legal obligations to retire tangible long-lived assets. The Statement requires an entity to recognize at fair value a liability associated with an asset retirement obligation in the period in which the liability is both incurred and in which the fair value is determinable. The provisions of this Statement are effective for the Company's fiscal year ended December 31, 2003, although earlier application is permitted. The Company has not completed its evaluation of SFAS No. 143 and has not yet determined the effect on its consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(tables in thousands, except share and per share data)
(Unaudited)

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of a long-lived asset or group of assets. This pronouncement, which supersedes and amends several earlier interpretations, establishes a single comprehensive statement to provide impairment accounting guidance for tangible long-lived assets to be either held and continued to be used by the entity or disposed of by sale or by some other means. This Statement will be effective for the first quarter of the Company's fiscal year ending December 31, 2002, although earlier application is permitted. The Company has determined that the adoption of this Statement does not have a material impact on its results of operations or consolidated financial position.

On January 1, 2002, the Company adopted the provisions of Statement of Position ("SOP") 01-6, Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others. The SOP was effective for financial statements issued for the fiscal year beginning after December 15, 2001. The Company has determined that the adoption of this SOP does not have a material impact on its results of operations or consolidated financial position.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64 and Technical Corrections." This Statement which rescinds and amends several statements, improves financial reporting for extinguishment of debt, modifies the accounting for certain leasing transactions, and makes various technical corrections to existing pronouncements. The Statement requires the gains and losses from the extinguishment of debt to be classified as extraordinary items only if they meet the criteria in APB Opinion No. 30, "Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." Also, the Statement requires that the accounting treatment of certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. The provisions for this Statement are required to be applied for fiscal years beginning after May 15, 2002, with earlier application encouraged. The Company has not completed its evaluation of SFAS No. 145 and has not yet determined the effect on its consolidated financial statements.

Reclassification of Prior Year Balances:

Certain reclassifications have been made to prior years' consolidated financial Statements to conform to the current presentation.

Commitments and Contingencies:

Please refer to Part II Other Information, Item 1 Legal Proceedings for information about pending litigation of the Company.

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

Three months ended June 30, 2002 as compared to the three months ended June 30, 2001.

Net income for the three months ended June 30, 2002 was approximately $2.0 million, a decrease of $3.2 million or 62% from the three months ended June 30,

2001. This represents diluted earnings per share for the three months ended June 30, 2002 of $0.15 per share on weighted-average outstanding shares of 12,901,149 as compared to $0.40 per share on weighted-average outstanding shares of 12,981,450 for the three months ended June 30, 2001.

Total revenues for the three months ended June 30, 2002 were $33.0 million, a decrease of $5.6 million, or 15%, from the three months ended June 30, 2001. The decrease was primarily due to a decrease of $4.3 million, or 24%, in financing leases and loans, and $1.6 million or 18% in fee and other income offset by an increase of $327,000 or 3% in rental and service contract income. The decrease in income on financing leases and loans was due to the decreased number of leases originated primarily resulting from the Company's decision to increase pricing and tighten its credit approval standards. The decrease in fee income and other income is the result of decreased fees from the lessees related to the collection and legal process employed by the Company. The increase in rental and service contract income is a result of the increased number of lessees that have continued to rent their equipment beyond their original lease term, an increase in the rental business originated through our Resource Leasing division, and an increase in orginations in rental and service contracts.

Selling, general and administrative expenses increased by $751,000, or 7%, for the three months ended June 30, 2002, as compared to the three months ended June 30, 2001. Marketing programs increased $472,000 or 306%, legal expenses increased $152,000 or 97%, and inventory services increased $127,000 or 232%.

Depreciation and amortization increased by $1.2 million or 33%, due to an increase in the number of early terminations of monthly cancelable contracts.

The Company's provision for credit losses decreased by $995,000, or 8%, for the three months ended June 30, 2002 as compared to the three months ended June 30, 2001. This decrease is a result of the Company's historical policy, based on experience, of providing a provision for credit losses based upon the dealer fundings and revenue recognized in any period and reflects management's judgement of loss potential considering current economic conditions and the nature of the underlying receivables.

Interest expense decreased by $875,000, or 25%, for the three months ended June 30, 2002 as compared to the three months ended June 30, 2001. This decrease resulted primarily from the Company's lower cost of funds, and an overall decrease in the level of borrowings.

Dealer fundings were $25.7 million for the three months ended June 30, 2002, down $1.7 million, or 6% as compared to the three months ended June 30, 2001. This decrease is a result of the Company's decision during the second quarter of 2000 to increase pricing and tighten its credit approval standards. The new credit policies were put into place in August of 2000. This is an ongoing effort, and is expected to continue going forward. Total cash from customers decreased by $2.5 million or 5% to a total of $45.0 million. This decrease is primarily the result of an decrease in the size of the overall portfolio. Investment in lease and loan receivables due in installments, estimated residuals, rental and service contracts were down from $470.6 million in December of 2001 to $455.1 million in June of 2002.

Six months ended June 30, 2002 as compared to the six months ended June 30, 2001.

Net income for the six months ended June 30, 2002 was approximately $5.2 million, a decrease of $5.4 million or 51% from the six months ended June 30, 2001. This represents diluted earnings per share for the six months ended June 30, 2002 of $0.40 per share on weighted-average outstanding shares of 12,877,839 as compared to $0.82 per share on weighted-average outstanding shares of 12,933,339 for the six months ended June 30, 2001.

Total revenues for the six months ended June 30, 2002 were $68.2 million, a decrease of $9.6 million, or 12%, from the six months ended June 30, 2001. The decrease was primarily due to a decrease of $7.8 million, or 21%, in

financing leases and loans, and $3.2 million or 17% in fee and other income offset by an increase of $1.3 million or 6% in rental and service contract income. The decrease in income on financing leases and loans was due to the decreased number of leases originated primarily resulting from the Company's change in its credit approval process. The decrease in fee income and other income is the result of decreased fees from the lessees related to the collection and legal process employed by the Company. The increase in rental and service contract income is a result of the increased number of lessees that have continued to rent their equipment beyond their original lease term, an increase in the rental business originated through our Resource Leasing division, and an increase in originations in rental and service contracts.

Selling, general and administrative expenses increased by $1.4 million, or 6%, for the six months ended June 30, 2002, as compared to the six months ended June 30, 2001. Marketing programs increased $647,000 or 130%, legal expenses increased $345,000 or 83%, professional service fees increased $240,000 or 20%, inventory services increased $154,000 or 59%, insurance expense increased $146,000 or 75%, debt closing expenses increased $116,000 or 32%, and lease expense increased $110,000 or 309%.

Depreciation and amortization increased by $1.4 million, or 20% due to an increase in the number of early terminations of monthly cancelable contracts.

The Company's provision for credit losses increased by $297,000, or 1%, for the six months ended June 30, 2002 as compared to the six months ended June 30, 2001. This increase is a result of the Company's historical policy, based on experience, of providing a provision for credit losses based upon the dealer fundings and revenue recognized in any period and reflects management's judgement of loss potential considering current economic conditions and the nature of the underlying receivables.

Interest expense decreased by $2.5 million, or 32%, for the six months ended June 30, 2002 as compared to the six months ended June 30, 2001. This decrease resulted primarily from the Company's lower cost of funds, and an overall decrease in the level of borrowings.

Dealer fundings were $48.3 million for the six months ended June 30, 2002, down $13.0 million, or 21% as compared to the six months ended June 30, 2001. This decrease is a result of the Company's decision during the second quarter of 2000 to increase pricing and tighten its credit approval standards, described below. The new credit policies were put into place in August of 2000. This is an ongoing effort, and is expected to continue going forward. Total cash from customers decreased by $3.4 million or 4% to a total of $91.7 million. This decrease is primarily the result of a decrease in the size of the overall portfolio. Investment in lease and loan receivables due in installments, estimated residuals, rental and service contracts were down from $470.6 million in December of 2001 to $455.1 million in June of 2002.

CRITICAL ACCOUNTING POLICIES

In response to the SEC's release No. 33-8040, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies," Management identified the most critical accounting principles upon which the Company's financial status depends. The Company determined the critical principles by considering accounting policies that involve the most complex or subjective decisions or assessments. Management identified the most critical accounting policies to be those related to revenue recognition and maintaining the allowance for credit losses. These accounting policies are discussed below as well as within the notes to the consolidated financial statements.

The Company's lease contracts are accounted for as financing leases. At origination, the Company records the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Amortization of unearned lease income and initial direct costs is suspended if, in the opinion of management, full payment of the contractual amount due under the lease agreement is doubtful. In conjunction with the origination of leases, the Company may retain a residual interest in the underlying equipment upon termination of the lease. The value of such interests is estimated at inception of the lease and evaluated periodically for impairment. Other revenues such as loss and damage waiver fees, service fees relating to the leases, contracts and loans, and rental revenues are recognized as they are earned.

The Company's investments in cancelable service contracts are recorded at cost and amortized over the expected life of the service period. Income on service contracts from monthly billings is recognized as the related services are provided. The Company periodically evaluates whether events or circumstances have occurred that may affect the estimated useful life or recoverability of the investment in service contracts. Rental equipment is either recorded at estimated residual value and depreciated using the straight-line method over a period of 12 months or at the acquisition cost and depreciated using the straight line method over a period of 36 months. Loans are reported at their outstanding principal balance. Interest income on loans is recognized as it is earned.

The Company maintains an allowance for credit losses on its investment in leases, service contracts, rental contracts and loans at an amount that it believes is sufficient to provide adequate protection against losses in its portfolio. The allowance is determined principally on the basis of the historical loss experience of the Company and the level of recourse provided by such lease, service contract, rental contract or loan, if any, and reflects management's judgment of additional loss potential considering current economic conditions and the nature and characteristics of the underlying lease portfolio. The Company determines the necessary periodic provision for credit losses taking into account actual and expected losses in the portfolio as a whole and the relationship of the allowance to the net investment in leases, service contracts, rental contracts and loans. Such provisions generally represent a percentage of funded amounts of leases, contracts and loans. The resulting charge is included in the provision for credit losses.

Leases and loans are charged against the allowance for credit losses and are put on non-accrual when they are deemed to be uncollectable. Generally, the Company deems leases, service contracts, rental contracts and loans to be uncollectable when one of the following occurs: (i) the obligor files for bankruptcy; (ii) the obligor dies, and the equipment is returned; or (iii) when an account has become 360 days delinquent without contact with lessee. The typical monthly payment under the Company's leases is between $30 and $50 per month. As a result of these small monthly payments, the Company's experience is that lessees will pay past due amounts later in the process because of the small amount necessary to bring an account current (at 360 days past due, a lessee will only owe lease payments of between $360 and $600).

The Company has developed and regularly updates proprietary credit scoring systems designed to improve its risk-based pricing. The Company uses credit scoring in most, but not all, of its extensions of credit. In addition, the Company aggressively employs collection procedures and a legal process to resolve any credit problems.

EXPOSURE TO CREDIT LOSSES

The following table sets forth certain information as of December 31, 2000 and 2001 and June 30, 2002 with respect to delinquent leases, service contracts and loans. The percentages in the table below represent the aggregate on such date of the actual amounts not paid on each invoice by the number of days past due, rather than the entire balance of a delinquent receivable, over the cumulative amount billed at such date from the date of origination on all leases, service contracts, and loans in the Company's portfolio. For example, if a receivable is 90 days past due, the portion of the receivable that is over 30 days past due will be placed in the 31-60 days past due category, the portion of the receivable which is over 60 days past due will be placed in the 61-90 days past due category and the portion of the receivable which is over 90 days past due will be placed in the over 90 days past due category. The Company historically used this methodology of calculating its delinquencies because of its experience that lessees who miss a payment do not necessarily default on the entire lease. Accordingly, the Company includes only the amount past due rather than the entire lease receivable in each category.

	As of December 31		As of June 30
	2000	2001	2002
Cumulative amounts billed (in thousands)	$462,011	$602,649	$610,084
31-60 days past due	1.9%	1.8%	2.4%
61-90 days past due	1.6%	1.7%	1.5%
Over 90 days past due	10.0%	13.4%	13.1%
Total past due	13.5%	16.9%	17.0%

LIQUIDITY AND CAPITAL RESOURCES

GENERAL

The Company's lease and finance business is capital-intensive and requires access to substantial short-term and long-term credit to fund new leases, loans and service contracts. Since inception, the Company has funded its operations primarily through borrowings under its credit facilities, issuances of subordinated debt and its on-balance sheet securitizations. The Company will continue to require significant additional capital to maintain and expand its volume of leases, loans, rentals and service contracts, as well as to fund future acquisitions of leasing companies or portfolios.

The Company's uses of cash include the origination and acquisition of leases, loans, rentals and service contracts, payment of interest expenses, repayment of borrowings under its credit facilities, subordinated debt and securitizations, payment of selling, general and administrative expenses, income taxes, capital expenditures, and the Company's stock repurchase program.

The Company utilizes its credit facility to fund the origination and acquisition of leases, loans, rentals and service contracts that satisfy the eligibility requirements established pursuant to each facility. Management is currently negotiating the terms and conditions under which both parties would agree to renew the credit facility. To the extent the existing line of credit is not renewed and no event of default exists, the credit facility will be automatically converted to a term loan on September 30, 2002. At June 30, 2002, the Company had an aggregate maximum of $192 million available for borrowing under its credit facility, of which approximately $125.9 million was outstanding as of such date. To date, cash flow from its portfolio and other fees have been sufficient to repay current amounts due under the credit facilities and subordinated debt.

The Company believes that the cash flow from its operations and the amounts available under its credit facilities will be sufficient to fund the Company's operations for the foreseeable future.

CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS

The Company has entered into various agreements, such as the long-term debt agreements, capital lease agreements and operating lease agreements that require future payments be made. Long-term debt agreements include all debt outstanding under the revolving credit line, securitizations, subordinated notes, demand notes and other notes payable.

At June 30, 2002 the repayment schedules for outstanding long-term debt, minimum lease payments under non-cancelable operating leases and future minimum lease payments under capital leases were as follows:

For the year ended December 31,	Long Term Debt	Operating Leases	Capital Leases	Tota
2002	$ 27,271	$ 698	$ 204	$ 28,
2003	37,625	1,343	267	39,
2004	5,126	417	169	5,
2005	--	214	55	
2006	2,600	--	--	2,
Thereafter	816	--	--	
	73,438	2,672	695	76,
Outstanding balance of revolving credit facility	125,869	--	--	125,
Total	$199,307	$2,672	$ 695	$202,

All balances under the revolving line of credit will be automatically converted to a term loan on September 30, 2002 provided the line of credit is not renewed and no event of default exists at that date. All converted term loans are payable over the term of the underlying leases, loans, rentals and service contracts, but in any event not to exceed 36 monthly installments.

Note on Forward-Looking Information

Statements in this document that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. In addition, words such as "believes," "anticipates," "expects," and similar expressions are intended to identify forward-looking statements. The Company cautions that a number of important factors could cause actual results to differ materially from those expressed in any forward-looking statements made by or on behalf of the Company. Such statements contain a number of risks and uncertainties, including but not limited to: the Company's dependence on point-of-sale authorization systems and expansion into new markets; the Company's significant capital requirements; risks associated with economic downturns; higher interest rates; intense competition; change in regulatory environment and risks associated with acquisitions. Readers should not place undue reliance on forward-looking statements, which reflect the management's view only as of the date hereof. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances. The Company cannot assure that it will be able to anticipate or respond timely to changes which could adversely affect its operating results in one or more fiscal quarters. Results of operations in any past period should not be considered indicative of results to be expected in future periods. Fluctuations in operating results may result in fluctuations in the price of the Company's common stock. For a more complete description of the prominent risks and uncertainties inherent in the Company's business, see the risks factors described in the Company's Form S-1 Registration Statement and other documents filed from time to time with the Securities and Exchange Commission.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market-Rate-Sensitive Instruments and Risk Management

The following discussion about the Company's risk management activities includes "forward-looking statements" that involve risk and uncertainties. Actual results could differ materially from those projected in the forward-looking statements.

In the normal course of operations, the Company also faces risks that are either nonfinancial or nonquantifiable. Such risks principally include country risk, credit risk and legal risk, and are not represented in the analysis that follows.

Interest Rate Risk Management

The implicit yield to the Company on all of its leases, loans, rentals and service contracts is on a fixed interest rate basis due to the leases, loans, rentals and service contracts having scheduled payments that are fixed at the time of origination of the lease, loan, rentals or service contract. When the Company originates or acquires leases, loans

and service contracts it bases its pricing in part on the "spread" it expects to achieve between the implicit yield rate to the Company on each lease, loan or service contract and the effective interest cost it will pay when it finances such leases, loans and service contracts through its credit facilities.

Increases in the interest rates during the term of each lease, loan or service contract could narrow or eliminate the spread, or result in a negative spread. The Company has adopted a policy designed to protect itself against interest rate volatility during the term of each lease, loan or service contract.

Given the relatively short average life of the Company's leases, loans, rentals and service contracts, the Company's goal is to maintain a blend of fixed and variable interest rate obligations. As of June 30, 2002, the Company's outstanding fixed rate indebtedness, including indebtedness outstanding under the Company's securitizations, represented 36.8% of the Company's outstanding indebtedness.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Management believes, after consultation with counsel, that the allegations against the Company included in the lawsuits described below are subject to substantial legal defenses, and the Company is vigorously defending each of the allegations. The Company also is subject to claims and suits arising in the ordinary course of business. At this time, it is not possible to estimate the ultimate loss or gain, if any, related to these lawsuits, nor if any such loss will have a material adverse effect on the Company's results of operations or financial position.

A. The Company filed an action in the United States District Court for the District of Massachusetts against Sentinel Insurance Company, Ltd., ("Sentinel"), Premier Holidays International, Inc., ("Premier") and Daniel DelPiano ("DelPiano") arising from Premier's October, 1999, default on its repayment obligations to the Company under a Twelve Million Dollar ($12,000,000) loan. Judgment has been entered in this case against Sentinel, which had issued a business performance insurance policy guaranteeing repayment of the loan, in the amount of Fourteen Million Dollars ($14,000,000). This judgment has not been satisfied. Sentinel is currently undergoing liquidation proceedings, and a claim in this amount has been filed with the bankruptcy court. Premier has asserted a counterclaim against the Company for Seven Hundred Sixty Nine Million Three Hundred Fifty Thousand dollars ($769,350,000) in actual and consequential damages, and for Five Hundred Million Dollars ($500,000,000) in punitive damages, plus interest, cost and attorney's fees. The counterclaim is based upon an alleged representation by the Company that it would lend Premier an additional Forty-Five Million Dollars ($45,000,000), when all documents evidencing the Premier loan refer only to the Twelve Million ($12,000,000) amount actually loaned and not repaid. The Company denies any liability on the counterclaim, which the Company is vigorously contesting. The Company has filed a motion for summary judgment, now pending before the Court, seeking dismissal of the counterclaim and the award of full damages on the Company's claims. Because of the uncertainties inherent in litigation, the Company cannot predict whether the outcome will have a material adverse effect.

B. On January 29, 2002, Leasecomm was served with an Amended Complaint ("Complaint") in an action entitled PEOPLE V. ROMA COMPUTER SOLUTIONS, INC., ET AL., Ventura County Superior Court Case No. CIV207490. The Complaint asserts two claims, one for violation of the California Business Professions Code Section 17500 (false advertising), and the other for violation of the California Business and Professions Code Section 17200 (unfair or unlawful acts or practices). The claims arise from the marketing and selling activities of other defendants, including Roma Computer Solutions, Inc., and/or Maro Securities, Inc. The Complaint seeks to have Leasecomm held liable for the acts of other defendants, alleging that Leasecomm directly participated in those acts and received proceeds and the assignment of lease contracts as a result of those acts. The Complaint requests injunctive relief, rescission, restitution, and a civil penalty. By agreement, no answer or motion need be filed until September 2002. Because of the uncertainties inherent in litigation, the Company cannot predict whether the outcome will have a material adverse affect.

C. On May 8, 2000, Plaintiff Efraim Bason brought an action in the Supreme Court of the State of New York, County of Nassau, seeking compensatory damages in the amount of $450,000 and punitive damages under various legal theories for Leasecomm's refusal to promptly release him from an equipment lease to which he claims his name was forged (the "Bason Complaint"). The Bason Complaint alleged that Leasecomm's failure to promptly release him from the lease, and subsequent negative reports to credit agencies, ruined his credit and prevented him from securing certain financing that he allegedly needed to purchase merchandise which he claims he could have then re-sold at a $450,000 profit. The Company filed a motion for summary judgment, which the Court has now granted awarding the Company judgment. Absent an appeal, the matter is over.

D. On January 29, 2002, Leasecomm was served with an Amended Complaint ("Complaint") in an action entitled RAE LYNN COPITKA V. LEASECOMM CORP., ET AL., Travis County (Texas) District Court Case No. GN-102292. The Complaint asserts that the original action, filed mid-2001 by a single plaintiff should proceed as a class action. In the original action, Ms. Copitka sought to rescind her finance lease with Leasecomm and to recover economic damages arising from prior payments under the lease. Ms. Copitka alleges that her proposed class includes all persons in Texas who have executed Leasecomm finance leases for "virtual terminal" type credit card software during the years 1998, 1999, 2000, and 2001. Leasecomm intends to vigorously contest both the class certification and the substantive merits of the lawsuit. No answer or motion has been filed. Because of the uncertainties inherent

in litigation, the Company cannot predict whether the outcome will have a material adverse effect on the Company's results of operations or consolidated financial position.

E. On April 3, 2000, a purported class action suit was filed in Superior Court of the State of California, County of San Mateo against Leasecomm and MicroFinancial as well as a number of other defendants with whom Leasecomm and MicroFinancial are alleged to have done business, directly or indirectly. The complaint seeks certification of a subclass of those class members who entered into any lease agreement contracts with Leasecomm for the purposes of financing the goods or services allegedly purchased from other defendant entities. The class action complaint alleges multiple causes of action, including: fraud and deceit; negligent misrepresentation; unfair competition; false advertising; unjust enrichment; fraud in the inducement and the inception of contract; lack of consideration for contact; and breach of the contractual covenant of good faith and fair dealing.

On February 1, 2002, the parties entered into stipulation of settlement to the class action litigation. The stipulation of settlement will be effective only if and when it is approved by the San Mateo Superior Court as fair and reasonable to the members of the plaintiff class and as a good faith settlement pursuant to Section 877.6 of the California Code of Civil Procedure. It is unclear at this point how long this process will take.

F. On October 29, 2001, a purported class action suit was filed in Superior Court of the State of California, County of Orange against Leasecomm and

MicroFinancial and another entity known as Prospecting Services of America, Inc. ("PSOA"). The plaintiffs purport to represent a class of customers who were allegedly solicited by PSOA to enter into leases with Leasecomm for the lease of a "virtual link point gateway" and "I-phone." Plaintiffs alleged that PSOA made numerous misrepresentations and omissions during the course of solicitation for which Leasecomm and MicroFinancial Incorporated should be responsible. On January 25, 2002, the trial court granted the motion of Leasecomm and MicroFinancial to stay the claims against them, on the grounds that the forum selection clause contained in the lease agreements required plaintiffs to litigate any claims against those entities in Massachusetts. In the event that this matter cannot be resolved, Leasecomm and MicroFinancial intend to vigorously defend the action. Because of the uncertainties inherent in litigation, the Company cannot predict whether the outcome will have a material adverse effect on the Company's results of operations or consolidated financial position.

G. On January 25, 2002, a purported class action suit was filed in Superior Court of the State of California, County of Los Angeles against Leasecomm. The complaint alleges that, two individuals were acting as agents of Leasecomm, and that they solicited the plaintiff to enter into a lease agreement with Leasecomm. The complaint seeks declaratory and injunctive relief against all defendants based upon alleged violations of California law. The plaintiff purports to represent two subclasses comprised of: business entities who entered into commercial lease agreements with Leasecomm, and all California residents who entered into lease agreements with Leasecomm for consumer goods. Leasecomm intends to vigorously defend the action. Because of the uncertainties inherent in litigation, the Company cannot predict whether the outcome will have a material adverse effect on the Company's results of operations or consolidated financial position.

Leasecomm has been served with Civil Investigative Demands by the Offices of the Attorney General for the states of Kansas, Illinois, Florida, and Texas, and for the Commonwealth of Massachusetts. Those Offices of the Attorney General, in conjunction with the Northwest Region Office of the Federal Trade Commission, the Offices of the Attorney General for North Carolina and North Dakota, and the Ventura County, California, District Attorney's Office, have informed Leasecomm that they are seeking to coordinate their investigations (collectively, the "Government Investigators"). At this time, the principal focus of the investigations appears to be software license leases (principally virtual terminals) and leases from certain vendor/dealers whose activities included business opportunity seminars. Leasecomm has further been informed that the investigations cover certain lease provisions, including the forum selection clause and language concerning the non-cancellability of the lease. In addition, the investigations include, among other things, whether Leasecomm's lease termination, or rollover, provisions, are legally sufficient; whether a Leasecomm lease is an enforceable lease; whether there were potential problems with its leases of which Leasecomm had knowledge; whether the leases are enforceable in accordance with their terms; whether three day right of rescission notices were required and, if required, whether proper notices were given; whether any lease prices were unconscionable; whether the lease of a software license is the lease of a service, not a good; whether any lease of satellites or computers are leases to consumers which must comply with certain consumer statutes; whether electronic fund transfer payments pursuant to a lease violate Reg. E; whether any

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Leasecomm billing and collection practices or charges are unreasonable, or constitute unfair or deceptive trade practices; whether Leasecomm's course of dealings with its vendors/dealers makes Leasecomm liable for any of the activities of its vendors/dealers. In April, 2002, Leasecomm and the Government Investigators entered into provisional relief and tolling agreements which provide for Leasecomm to take certain interim actions, toll the running of the statute of limitations as of January 29, 2002, and require advance notice by Leasecomm of its withdrawal from the provisional relief agreement and advance notice by each of the Government Investigators of its intention to commence legal action.

Since the investigations are in process, and no legal action has been commenced against Leasecomm, there can be no assurance as to the eventual outcome.

In May, 2002, the Company received notice from an attorney in New York City who advised the Company that he intended to bring suit against the Company on behalf of a class of approximately 150 lessees of one of the Company's lease products. Since that time, the attorney has refused the Company's several requests to identify the legal theories and facts which would be the basis for any claims against the Company, stating only that the leases were unconscionable and are unenforceable. The Company cannot predict whether suit will eventually be brought on behalf of one or more of these lessees or, if it is, what the outcome of the suit would be and, therefore, whether it could have a material adverse effect.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibit is filed herewith:

Exhibit 99.1	Certification of Chief Executive Officer, Chief Operating Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) None.

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.

MicroFinancial Incorporated

By: /s/ Peter R. Bleyeben

Chairman of the Board and Chief Executive Officer

By: /s/ Richard F. Latour

President, and Chief Operating Officer

By: /s/ James R. Jackson

Chief Financial Officer

Date: August 14, 2002