FINANCIAL FEDERAL CORP
Form 10-Q
March 08, 2007

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

FORM 10-Q

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

For the quarterly period ended January 31, 2007

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 number 1-12006

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

Nevada	88-0244792
(State of incorporation)	(I.R.S. Employer Identification No.)

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

Registrant's telephone number, including area code (212) 599-8000

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 |_|

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

Large accelerated filer |X| Accelerated filer |_| Non-accelerated filer |_|

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

The number of shares outstanding of the registrant's common stock on March 1, 2007 was 27,501,548.

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FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

Quarterly Report on Form 10-Q
for the quarter ended January 31, 2007

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(In thousands, except par value)

	January 31, 2007*	July 31, 2006
ASSETS		
Finance receivables	$2,050,948	$1,991,688
Allowance for credit losses	(24,148)	(24,100)
Finance receivables - net	2,026,800	1,967,588
Cash	5,293	8,143
Other assets	10,228	12,613
TOTAL ASSETS	$2,042,321	$1,988,344
LIABILITIES		
Debt:		
Long-term ($4,400 at January 31, 2007 and $5,700 at July 31, 2006 owed to related parties)	$1,253,100	$1,252,350
Short-term	297,268	275,311
Accrued interest, taxes and other liabilities	76,547	70,304
Total liabilities	1,626,915	1,597,965
STOCKHOLDERS' EQUITY		
Preferred stock - $1 par value, authorized 5,000 shares	--	--
Common stock - $.50 par value, authorized 100,000 shares, shares issued and outstanding (net of 1,696 treasury shares): 27,376 at January 31, 2007 and 27,216 at July 31, 2006	13,688	13,608
Additional paid-in capital	129,698	123,091
Retained earnings	270,911	253,128
Accumulated other comprehensive income	1,109	552
Total stockholders' equity	415,406	390,379
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$2,042,321	$1,988,344

* Unaudited

See accompanying notes to consolidated financial statements

FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED INCOME STATEMENTS *
(In thousands, except per share amounts)

	Three Months Ended January 31,		Six Months Ended January 31,	
	2007	2006	2007	2006
Finance income	$47,383	$39,438	$94,313	$75,991

Interest expense	21,073	16,045	41,965	30,291
Net finance income before provision for credit losses on finance receivables	26,310	23,393	52,348	45,700
Provision for credit losses on finance receivables	--	--	--	--
Net finance income	26,310	23,393	52,348	45,700
Salaries and other expenses	6,142	5,761	12,251	11,259
Income before provision for income taxes	20,168	17,632	40,097	34,441
Provision for income taxes	7,773	6,904	15,472	13,468
NET INCOME	$12,395	$10,728	$24,625	$20,973
EARNINGS PER COMMON SHARE:				
Diluted	$ 0.46	$ 0.41	$ 0.92	$ 0.80
Basic	$ 0.47	$ 0.42	$ 0.94	$ 0.81

* Unaudited

See accompanying notes to consolidated financial statements

FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY *
(In thousands)

	Common Stock		Additional		Accumulated Other	
	Shares	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income	
BALANCE - JULY 31, 2005	26,231	$13,116	$109,226	$219,772	$ --	$3
Net income	--	--	--	20,973	--	
Unrealized gain on cash flow hedge, net of tax	--	--	--	--	364	
						--
Comprehensive income						
						--
Stock plan activity:						
Shares issued	315	157	3,793	(52)	--	
Compensation recognized	--	--	2,647	--	--	
Excess tax benefits	--	--	981	--	--	

	Shares	Amount	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income	
Common stock cash dividends	--	--	--	(4,403)	--	
Cash paid for fractional shares	(4)	(2)	--	(107)	--	
BALANCE - JANUARY 31, 2006	26,542	$13,271	$116,647	$236,183	$ 364	$3

	Common Stock		Additional		Accumulated Other	
	Shares	Amount	Paid-In Capital	Retained Earnings	Comprehensive Income	
BALANCE - JULY 31, 2006	27,216	$13,608	$123,091	$253,128	$ 552	$3
Net income	--	--	--	24,625	--	
Unrealized gain on cash flow hedge, net of tax	--	--	--	--	616	
Reclassification adjustment for realized gain included in net income, net of tax	--	--	--	--	(59)	
						--
Comprehensive income						
						--
Common stock repurchased (retired)	(5)	(3)	(125)	(6)	--	
Stock plan activity:						
Shares issued	174	87	2,935	--	--	
Shares canceled	(9)	(4)	4	--	--	
Compensation recognized	--	--	3,282	--	--	
Excess tax benefits	--	--	511	--	--	
Common stock cash dividends	--	--	--	(6,836)	--	
BALANCE - JANUARY 31, 2007	27,376	$13,688	$129,698	$270,911	$ 1,109	$4

* Unaudited

See accompanying notes to consolidated financial statements

FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS *
(In thousands)

Six Months Ended January 31,	2007	2006
Cash flows from operating activities:		
Net income	$ 24,625	$ 20,973
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred origination costs and fees	8,079	7,402

Stock-based compensation	1,838	2,647
Depreciation and amortization	304	436
Decrease in other assets	2,022	1,619
Increase in accrued interest, taxes and other liabilities	7,964	8,288
Excess tax benefits from stock-based awards	(511)	(981)
Net cash provided by operating activities	44,321	40,384
Cash flows from investing activities:		
Finance receivables originated	(603,777)	(647,885)
Finance receivables collected	537,930	496,047
Net cash used in investing activities	(65,847)	(151,838)
Cash flows from financing activities:		
Commercial paper, net increase	178,349	22,000
Bank borrowings, net decrease	(132,242)	(29,000)
Asset securitization borrowings	--	100,000
Proceeds from term notes	--	50,000
Repayment of term notes	(25,000)	(32,500)
Proceeds from settlement of interest rate locks	1,006	--
Proceeds from stock option exercises	2,977	3,898
Excess tax benefits from stock-based awards	511	981
Common stock issued	45	--
Common stock cash dividends	(6,836)	(4,403)
Repurchases of common stock	(134)	--
Cash paid for fractional shares of common stock	--	(109)
Net cash provided by financing activities	18,676	110,867
NET DECREASE IN CASH	(2,850)	(587)
Cash - beginning of period	8,143	8,456
CASH - END OF PERIOD	$ 5,293	$ 7,869

* Unaudited

See accompanying notes to consolidated financial statements

FINANCIAL FEDERAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands, except per share amounts)
(Unaudited)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Financial Federal Corporation and subsidiaries (the "Company") provide collateralized lending, financing and leasing services nationwide to small and medium sized businesses in the general construction, road and infrastructure construction and repair, road transportation and waste disposal industries. We lend against, finance and lease a wide range of new and used revenue-producing, essential-use equipment including cranes, earthmovers, personnel lifts, trailers

and trucks.

Basis of Presentation and Principles of Consolidation

We prepared the accompanying unaudited Consolidated Financial Statements according to the Securities and Exchange Commission's rules and regulations. These rules and regulations permit condensing or omitting certain information and note disclosures normally included in financial statements prepared according to accounting principles generally accepted in the United States of America (GAAP). The July 31, 2006 Consolidated Balance Sheet was derived from audited financial statements but does not include all disclosures required by GAAP. However, we believe the disclosures are sufficient to make the information presented not misleading. These Consolidated Financial Statements and accompanying notes should be read with the Consolidated Financial Statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended July 31, 2006.

In our opinion, the Consolidated Financial Statements include all adjustments (consisting of only normal recurring items) necessary to present fairly our financial position and results of operations for the periods presented. The results of operations for the three and six months ended January 31, 2007 may not be indicative of full year results.

We split our common stock 3-for-2 in the form of a stock dividend in January 2006. All share and per share amounts (including stock options, restricted stock and stock units), excluding treasury stock, in the Consolidated Financial Statements and accompanying notes were restated to reflect the split. We did not split shares of treasury stock.

Use of Estimates

GAAP requires us to make significant estimates and assumptions affecting the amounts reported in the Consolidated Financial Statements and accompanying notes for the allowance for credit losses, non-performing assets, residual values and stock-based compensation. Actual results could differ from these estimates significantly.

New Accounting Standards

The Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB 109", ("FIN No. 48") in July 2006. FIN No. 48 requires companies to determine if any tax positions taken on their income tax returns lowering the amount of tax currently due would more likely than not be allowed by a taxing jurisdiction. If tax positions pass the more-likely-than-not test, companies then record benefits from them only equal to the highest amount that has a greater than 50% chance of being realized assuming the tax positions would be challenged by a taxing jurisdiction. No benefits would be recorded for tax positions failing the more-likely-than-not test. Tax benefits include income tax savings and the related interest expense savings. Whether tax positions pass the test or not, adopting FIN No. 48 could result in additional income tax provisions or expenses for any interest and penalties on potential underpayments of income tax, or both. FIN No. 48 is effective in the first quarter of fiscal years beginning after December 15, 2006. It will become effective for us on August 1, 2007, the beginning of our fiscal year ending July 31, 2008. We are evaluating how it may affect our consolidated financial statements.

The FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements", ("SFAS No. 157") in September 2006. SFAS No. 157 defines fair value (replacing all prior definitions) and creates a framework to measure fair value, but does not create any new fair value measurements. SFAS No. 157 is effective in the first quarter of fiscal years beginning after

November 15, 2007. It will become effective for us on August 1, 2008. We are evaluating how it may affect our consolidated financial statements.

The FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115" in February 2007. SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value at specified election dates and to report unrealized gains and losses on these items in earnings at each subsequent reporting date. SFAS No. 159 is effective in the first quarter of fiscal years beginning after November 15, 2007. It will become effective for us on August 1, 2008. We are evaluating how it may affect our consolidated financial statements.

NOTE 2 - FINANCE RECEIVABLES

Finance receivables comprise installment sale agreements and secured loans (including line of credit arrangements), collectively referred to as loans, with fixed or floating (indexed to the prime rate) interest rates, and direct financing leases as follows:

	January 31, 2007	July 31, 2006
Loans:		
Fixed rate	$1,694,433	$1,662,805
Floating rate	153,141	131,235
Total loans	1,847,574	1,794,040
Direct financing leases *	203,374	197,648
Finance receivables	$2,050,948	$1,991,688

* includes residual values of $41,300 at January 31, 2007 and $41,200 at July 31, 2006

We also provide commitments to extend credit. These commitments contain off-balance sheet risk and are subject to the same credit policies and procedures as finance receivables. The unused portion of these commitments was $36,600 at January 31, 2007 and $23,800 at July 31, 2006.

The allowance for credit losses activity is summarized below:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2007	2006	2007	2006
Allowance - beginning of period	$24,047	$24,188	$24,100	$24,225
Provision	--	--	--	--
Write-downs	(503)	(1,003)	(1,150)	(1,855)
Recoveries	604	931	1,198	1,746
Allowance - end of period	$24,148	$24,116	$24,148	$24,116

Percentage of finance receivables	1.18%	1.33%	1.18%	1.33%
Net charge-offs (recoveries) *	$ (101)	$ 72	$ (48)	$ 109
Loss ratio **	(0.02)%	0.02%	(0.01)%	0.01%

* write-downs less recoveries
** net charge-offs (recoveries) over average finance receivables, annualized

Non-performing assets comprise finance receivables classified as non-accrual (income recognition has been suspended and the receivables are considered impaired) and assets received to satisfy finance receivables (repossessed equipment, included in other assets) as follows:

	January 31, 2007	July 31, 2006
Finance receivables classified as non-accrual	$13,478	$13,750
Assets received to satisfy finance receivables	2,022	809
Non-performing assets	$15,500	$14,559

The allowance for credit losses included $200 at January 31, 2007 and $300 at July 31, 2006 specifically allocated to $2,800 and $6,700 of impaired finance receivables, respectively. We did not recognize any income in the six months ended January 31, 2007 or 2006 on impaired loans before collecting our net investment.

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NOTE 3 - DEBT

Debt is summarized below:

	January 31, 2007	July 31, 2006
Fixed rate term notes:		
5.00% due 2010 - 2011	$ 250,000	$ 250,000
5.45% - 5.56% due 2011 - 2013	200,000	200,000
5.92% - 6.80% due 2007 - 2008	36,250	61,250
Total fixed rate term notes	486,250	511,250
Fixed rate term notes swapped to floating rates due 2008 - 2010	143,250	143,250
Floating rate term note	--	10,000
2.0% convertible debentures due 2034	175,000	175,000
Total term debt	804,500	839,500
Asset securitization financings	425,000	425,000
Commercial paper	297,188	118,839
Bank borrowings	27,480	149,722
Total principal	1,554,168	1,533,061

Fair value adjustment of hedged debt	(3,800)	(5,400)
Total debt	$1,550,368	$1,527,661

Term Notes

We repaid $25,000 of 5.92% fixed rate term notes at maturity and we converted a $10,000 floating rate term note from a bank due in fiscal 2008 to a $15,000 three-year committed unsecured revolving credit facility in the first half of fiscal 2007.

Convertible Debentures

We irrevocably elected (under the existing terms of the debentures and without modifying the debentures) in fiscal 2005 to pay the value of converted debentures, not exceeding the principal amount, in cash instead of issuing shares of our common stock. As a result, the 6,134,000 convertible shares are no longer issuable upon conversion but we would need to pay any value over principal by issuing shares of common stock and the value of the debentures is still determined by the number of convertible shares. The value of converted debentures would exceed the principal amount when the price of our common stock exceeds the conversion price. Shares needed to pay the value over principal would equal the difference between the conversion date price of our common stock and the conversion price, divided by the conversion date price of our common stock and multiplied by the number of converted shares. No event allowing for the debentures to be converted has occurred through January 31, 2007.

The conversion rate increased in October and December 2006 because we declared cash dividends on our common stock. At January 31, 2007, the conversion rate was 35.05 (number of convertible shares for each $1 (one thousand) of principal), the conversion price was $28.53 and we would have to deliver the value of 6,134,000 shares of our common stock upon conversion of all the debentures. The conversion rate, conversion price and number of convertible shares at July 31, 2006 were 34.75, $28.78 and 6,081,000, respectively. Future cash dividends will cause additional conversion rate and convertible shares increases and conversion price decreases.

Asset Securitization Financings

We have a $425,000 asset securitization facility providing committed revolving financing for one year. If the facility is not renewed before its current expiration in April 2007, we could convert borrowings outstanding into term debt. The term debt would be repaid monthly based on the amount of securitized receivables and would be fully repaid by August 2009. Finance receivables include $475,000 and $487,000 of securitized receivables at January 31, 2007 and July 31, 2006, respectively. We can securitize an additional $341,000 of finance receivables at January 31, 2007. Borrowings are limited to 94% of securitized receivables and can be further limited based on the eligibility of securitized receivables.

Bank Borrowings

We have $495,000 of committed unsecured revolving credit facilities from ten banks expiring as follows; $187,500 within one year and $307,500 between September 2008 and October 2012.

Other

Our major operating subsidiary's debt agreements have restrictive covenants including limits on its indebtedness, encumbrances, investments, dividends and other distributions to us, sales of assets, mergers and other business combinations, capital expenditures, interest coverage and net worth. We were in compliance with all debt covenants at January 31, 2007. None of the agreements have a material adverse change clause. All of our debt is senior.

Long-term debt comprised the following:

	January 31, 2007	July 31, 2006
Term notes	$ 558,600	$ 602,850
Bank borrowings and commercial paper supported by bank credit facilities expiring after one year	307,500	247,500
Asset securitization financings	212,000	227,000
Convertible debentures	175,000	175,000
Total long-term debt	$1,253,100	$1,252,350

NOTE 4 - DERIVATIVES

We entered into interest rate locks with a total notional amount of $100,000 with three counterparty banks in September 2006. The rate locks had a March 2007 expiration. We designated the rate locks as cash flow hedges of our anticipated issuance of five-year fixed rate term notes hedging the risk of interest rate changes, on the interest payments of the notes, through the date the interest rate is set on the note issuance. We terminated the rate locks in January 2007 and realized a $1,006 gain. This cash flow hedge gain was recorded in stockholders' equity as accumulated other comprehensive income net of deferred income taxes of $390, and will be reclassified into net income by reducing interest expense and deferred income tax expense over the five-year term of the notes expected to be issued in our third quarter of fiscal 2007.

We also have fixed to floating interest rate swaps with a total notional amount of $143,250 at January 31, 2007 and July 31, 2006. The swaps effectively converted fixed rate term notes into floating rate term notes. We designated the swaps as fair value hedges of fixed rate term notes. The swaps expire on the notes' maturity dates. Semiannually, we receive fixed amounts from the swap counterparty banks equal to the interest we pay on the hedged fixed-rate notes, and we pay amounts to the swap counterparty banks equal to the swaps' floating rates multiplied by the swaps' notional amounts. We record the differences between these amounts in interest expense. The swaps' floating rates change every six months to a fixed amount over six-month LIBOR. We receive a weighted-average fixed rate of 4.88% and the weighted-average floating pay rate was 6.93% at January 31, 2007 and 6.89% at July 31, 2006. The fair value of the swaps was a liability of $3,800 at January 31, 2007 and $5,400 at July 31, 2006.

NOTE 5 - STOCKHOLDERS' EQUITY

We paid quarterly cash dividends of $0.25 per share of common stock in the first half of fiscal 2007. We also received and retired 5,000 shares of common stock from our CEO at $27.21 per share as payment of income taxes we were required to withhold on vested shares of restricted stock. At January 31, 2007, $17,400 was available for future repurchases under our repurchase program. In March 2007, we declared a quarterly cash dividend of $0.15 per share of common stock payable in April 2007, and we increased the amount available for future

repurchases under our repurchase program by $2,600.

NOTE 6 - STOCK PLANS

Our stockholders approved two stock plans in December 2006; the 2006 Stock Incentive Plan (the "2006 Plan") and the Amended and Restated 2001 Management Incentive Plan (the "Amended MIP"). The 2006 Plan provides for the issuance of 2,500,000 incentive or non-qualified stock options, shares of restricted stock, stock appreciation rights, stock units and common stock to officers, other employees and directors subject to annual participant limits , and expires in December 2016. Awards may be subject to performance goals. The 2006 Plan replaced the 1998 Stock Option/Restricted Stock Plan (the "1998 Plan"). The 1998 Plan terminated upon approval of the 2006 Plan. The exercise price of incentive stock options granted under these plans can not be less than the fair market value of our common stock when granted and the

term of incentive stock options is limited to ten years. At January 31, 2007, 2,480,000 shares were available for future grants under the 2006 Plan. The Amended MIP provides for the issuance of 1,000,000 shares of restricted stock, with an annual participant limit of 200,000 shares, and cash or stock bonuses to be awarded to our CEO and other selected officers subject to predetermined performance goals. The Amended MIP expires in December 2011. At January 31, 2007, 750,000 shares were available for future grants under the Amended MIP.

The 1998 Plan was amended in December 2005 to increase the number of shares available for the January 2006 stock split according to its anti-dilution provisions. The 1998 Plan provided for the issuance of 3,750,000 incentive or non-qualified stock options or shares of restricted stock to officers, other employees and directors. None of the options or shares of restricted stock awarded under the 1998 Plan are performance based.

Options granted through the first half of fiscal 2005 were mostly incentive stock options with a six-year term vesting 25% after two, three, four and five years. Options granted in the second half of fiscal 2005 were non-qualified options with a four-year term vesting 33 1/3% on July 31, 2005, 2006 and 2007. Options granted in fiscal 2006 were non-qualified options with a five-year term vesting 25% after one, two, three and four years.

Shares of restricted stock awarded (excluding 435,000 shares awarded to executive officers in February 2006) vest annually in equal amounts over original periods of three to eight years (seven year weighted-average). Shares of restricted stock awarded to executive officers in February 2006 vest when the officer's service terminates, other than upon a non-qualifying termination, after six months after (i) the executive officer attains age 62 or (ii) after August 2026 if earlier (twelve year weighted-average).

We awarded 19,000 restricted stock units under the 2006 Plan to non-employee directors in January 2007. The units vest in one year or earlier upon the sale of the Company or the director's death or disability, and are subject to forfeiture. Each unit represents the right to receive one share of common stock and the units earn dividend equivalents to be paid by increasing the number of units. Vested units will be converted into shares of common stock after the director's service terminates. We also issued 1,500 shares of common stock under the 2006 Plan as payment of annual director retainer fees. The price of our common stock on the date we issued these shares was $28.73.

The Management Incentive Plan ("MIP") for our Chief Executive Officer

("CEO") was approved by stockholders in fiscal 2002. We amended it in December 2005 according to its anti-dilution provisions to increase the number of shares for the January 2006 stock split. We awarded 41,000 shares of restricted stock to our CEO in November 2005 as part of the fiscal 2006 bonus subject to certain performance conditions. Shares earned vest annually in equal amounts over four years. Our CEO earned 36,000 of these shares in September 2006 and forfeited 5,000 shares based on our fiscal 2006 performance. Our CEO earned 27,000 shares of restricted stock in September 2005 vesting annually in equal amounts over four years as a bonus for fiscal 2005. Our CEO earned 15,000 shares of restricted stock in fiscal 2005 vesting annually in equal amounts over five years as part of the fiscal 2004 bonus. No shares were awarded for fiscal 2007. At January 31, 2007, 119,000 shares of our CEO's restricted stock awarded under the MIP were unvested and are scheduled to vest over approximately four years.

We established a Supplemental Retirement Benefit ("SERP") for our CEO in fiscal 2002. We amended it in December 2005 according to its anti-dilution provisions to increase the number of units for the January 2006 stock split, and we amended it in March 2006 to provide for dividend equivalent payments. We awarded 150,000 stock units vesting annually in equal amounts over eight years. Subject to forfeiture, our CEO will receive shares of common stock equal to the number of stock units vested when our CEO retires. At January 31, 2007, 94,000 units were vested. Amending the SERP in fiscal 2006 to provide for dividend equivalent payments increased the fair value of these units to $23.93 from $22.43 and increased the total cost of the units by $225.

The restricted stock agreements (excluding the executive officers' February 2006 agreements) and the SERP provide for all unvested shares or stock units to vest immediately when certain events occur including the sale of the Company, the officer's death or disability and qualifying employment terminations. Unvested shares are also subject to forfeiture. The executive officers' February 2006 restricted stock agreements provide for (i) all shares to vest immediately upon the sale of the Company or the executive officer's death or disability (ii) a portion (based on the percentage of the vesting period elapsed) of the shares to vest immediately upon a qualifying employment termination and (iii) forfeiture of all shares upon a non-qualifying employment termination. Dividends are paid on all unvested shares of restricted stock. The restricted stock agreements and the SERP (as amended in March 2006) also allow employees to pay income taxes required to be withheld at vesting by surrendering a portion of the shares or units vested.

Stock options, shares of restricted stock and stock units are the only incentive compensation we provide (other than a cash bonus for the CEO) and we believe these stock-based awards further align employees' and directors' objectives with those of our stockholders. We issue new shares when options are exercised or when we award shares of restricted stock, and we do not have a policy to repurchase shares in the open market when options are exercised or when we award shares of restricted stock.

Stock option activity and related information for the six months ended January 31, 2007 are summarized below (options and intrinsic value in thousands):

		Weighted-Average		
	Options	Exercise Price	Remaining Term (years)	Intrinsic Value*

Outstanding - August 1, 2006	1,527	$20.71		
Granted	--	--		
Exercised	(172)	17.32		
Forfeited	(47)			
Outstanding - January 31, 2007	1,308	21.11	2.4	$9,800
Exercisable - January 31, 2007	566	$19.00	1.7	$5,400

* number of options multiplied by the difference between the $28.60 closing price of our common stock on January 31, 2007 and the weighted-average exercise price

Information on stock option exercises follows (in thousands, except intrinsic value per option):

Six Months Ended January 31,	2007	2006
Number of options exercised	172	247
Total intrinsic value *	$1,850	$3,100
Intrinsic value per option	10.77	12.57
Excess tax benefits realized	499	980

* options exercised multiplied by the difference between the closing prices of our common stock on the exercise dates and the exercise prices

Restricted stock activity under the 1998 Plan and the MIP, and related information for the six months ended January 31, 2007, are summarized below (shares in thousands):

	Shares	Weighted-Average Grant-Date Fair Value
Unvested - August 1, 2006	1,081	$24.66
Granted	--	--
Vested	(19)	26.02
Forfeited	(9)	
Unvested - January 31, 2007	1,053	24.61

Information on shares of restricted stock that vested follows (in thousands, except intrinsic value per share):

Six Months Ended January 31,	2007	2006
Number of shares vested	19	3
Total intrinsic value *	$ 517	$ 77
Intrinsic value per share	27.21	25.63
Excess tax benefits realized	12	1

* shares vested multiplied by the closing prices of our common stock on the dates vested

Future compensation expense (before deferral under SFAS No. 91) for stock-based awards unvested at January 31, 2007 and expected to vest, and the weighted-average periods the expense will be recognized over are as follows:

	Expense	Weighted-Average Years
Restricted stock	$17,800	6.3
Stock options	1,400	2.2
Stock units	1,700	2.5
Total	$20,900	5.8

Total compensation recorded, compensation capitalized (deferred recognizing) under SFAS No. 91, compensation included in salaries and other expenses and tax benefits recorded for stock-based awards follow:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2007	2006	2007	2006
Compensation for stock options:				
Total recorded	$ 285	$ 485	$ 574	$ 980
Capitalized under SFAS No. 91	174	286	351	576
Included in salaries and other expenses	$ 111	$ 199	$ 223	$ 404
Tax benefits recorded	$ 16	$ 27	$ 32	$ 57
Compensation for shares of restricted stock and stock units:				
Total recorded	$1,334	$ 794	$2,708	$1,667
Capitalized under SFAS No. 91	535	344	1,093	724
Included in salaries and other expenses	$ 799	$ 450	$1,615	$ 943
Tax benefits recorded	$ 304	$ 170	$ 616	$ 360
Total stock-based compensation:				
Total recorded	$1,619	$1,279	$3,282	$2,647
Capitalized under SFAS No. 91	709	630	1,444	1,300
Included in salaries and other expenses	$ 910	$ 649	$1,838	$1,347
Tax benefits recorded	$ 320	$ 197	$ 648	$ 417

NOTE 7 - EARNINGS PER COMMON SHARE

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

	Three Months Ended January 31,		Six Months Ended January 31,	
	2007	2006	2007	2006
Net income	$12,395	$10,728	$24,625	$20,973
Weighted average common shares outstanding (used for basic EPS)	26,289	25,799	26,242	25,760
Effect of dilutive securities:				
Stock options	292	391	289	347
Shares of restricted stock and stock units	321	254	297	225
Adjusted weighted average common shares outstanding (used for diluted EPS)	26,902	26,444	26,828	26,332
Earnings per common share:				
Diluted	$ 0.46	$ 0.41	$ 0.92	$ 0.80
Basic	0.47	0.42	0.94	0.81
Antidilutive stock options, shares of restricted stock and stock units *	144	--	147	338

* excluded from the calculation because they would have increased diluted EPS

The convertible debentures will lower diluted EPS when the quarterly average price of our common stock exceeds the adjusted conversion price. In fiscal periods when the average price of our common stock exceeds the adjusted conversion price, shares of common stock needed to deliver the value of the debentures over their principal amount based on the average stock price would be included as shares outstanding in calculating diluted EPS. Shares to be included would equal the difference between the average stock price and the adjusted conversion price, divided by the average stock price and multiplied by the number of convertible shares, currently 6,134,000 (referred to as the treasury stock method). The average price of our common stock was $28.21 and $27.71 for the three and six months ended January 31, 2007, respectively, and the adjusted conversion price was $28.53 at January 31, 2007.

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

OVERVIEW

Financial Federal Corporation is an independent financial services company operating in the United States through three wholly owned subsidiaries. We do not have any unconsolidated subsidiaries, partnerships or joint ventures. We also do not have any off-balance sheet assets or liabilities (other than commitments to extend credit), goodwill, other intangible assets or pension obligations, and we are not involved in income tax shelters. We have one fully consolidated special purpose entity we established for our on-balance-sheet

asset securitization facility.

We have one line of business. We lend money under installment sale agreements, secured loans and leases (collectively referred to as "finance receivables") to small and medium sized businesses for their equipment financing needs. Finance receivable transactions generally range between $50,000 and $1.0 million, have terms generally ranging between two and five years and provide for monthly payments. The average transaction size is approximately $200,000. We earn revenue solely from interest and other fees and amounts earned on our finance receivables. We need to borrow most of the money we lend; therefore liquidity (money currently available for us to borrow) is important. We borrow from banks and insurance companies and we issue commercial paper to other investors. Approximately 75% of our finance receivables were funded with debt at January 31, 2007.

We focus on (i) maximizing the difference between the rates we earn on our receivables and the rates we incur on our debt ("net interest spread") (ii) maintaining the asset quality of our receivables and (iii) managing our interest rate risk. At January 31, 2007, interest rates on our finance receivables were 93% fixed and 7% floating, and interest rates on our debt were 43% fixed and 57% floating. Therefore, changes in market interest rates affect our profitability significantly. The asset quality of our finance receivables can also affect our profitability significantly. Asset quality can affect finance income, provisions for credit losses and operating expenses through reclassifying receivables to or from non-accrual status, incurring write-downs and incurring costs associated with non-performing assets. We use various strategies to manage our interest rate risk and credit risk.

Our main areas of focus are asset quality, liquidity and interest rate risk. We discuss each in detail in separate sections of this discussion. These areas are integral to our long-term profitability. Our key operating statistics are net charge-offs, loss ratio, non-performing assets, delinquencies, receivables growth, leverage, available liquidity, net interest margin and net interest spread, and expense and efficiency ratios.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Accounting principles generally accepted in the United States require judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended July 31, 2006 describes the significant accounting policies and methods used to prepare the Consolidated Financial Statements. Accounting policies involving significant judgment, assumptions and estimates are considered critical accounting policies and are described below.

Allowance for Credit Losses

The allowance for credit losses on finance receivables is our estimate of losses inherent in our finance receivables at the balance sheet date. The allowance is difficult to determine and requires significant judgment. The allowance is based on total finance receivables, net charge-off experience, non-accrual and delinquent finance receivables and our current assessment of the risks inherent in our finance receivables from national and regional economic conditions, industry conditions, concentrations, the financial condition of customers and guarantors, collateral values and other factors. We may need to change the allowance level significantly if unexpected changes in these

conditions or factors occur. Increases in the allowance would reduce net income through higher provisions for credit losses. The allowance was $24.1 million (1.18% of finance receivables) at January 31, 2007 including $0.2 million specifically allocated to impaired receivables.

The allowance includes amounts specifically allocated to impaired receivables and an amount to provide for losses inherent in the remainder of finance receivables (the "general allowance"). We evaluate the fair value of an impaired receivable and compare it to the carrying amount. The carrying amount is the amount the receivable is recorded at when we evaluate the receivable and may include a prior write-down or specific allowance. If our estimate of fair value is lower than the carrying amount, we record a write-down or establish a specific allowance based on (i) how we determined fair value (ii) how certain we are of our estimate and (iii) the level and type of factors and items other than the primary collateral, such as guarantees and secondary collateral, supporting our fair value estimate.

To estimate the general allowance, we analyze historical write-down activity to develop percentage loss ranges by risk profile. Risk profiles are assigned to receivables based on past due status and the customers' industry. We then adjust the calculated range of losses for expected recoveries and we may also adjust the range for differences between current and historical loss trends and other factors to arrive at the estimated allowance. We record a provision for credit losses if the recorded allowance differs from our current estimate. Although our method is designed to calculate probable losses, because significant estimates are used, the adjusted calculated range of losses may differ from actual losses significantly.

Non-performing assets

We record impaired finance receivables at their current estimated fair value (if less than their carrying amount). We record assets received to satisfy receivables at their current estimated fair value less selling costs (if less than their carrying amount). We estimate fair value of non-performing assets by evaluating the expected cash flows of impaired receivables and the market value and condition of the collateral or assets. We evaluate market value by analyzing recent sales of similar equipment and used equipment publications, using our market knowledge and making inquiries of equipment vendors. Unexpected adverse changes in or incorrect conclusions on expected cash flows, market value or the condition of collateral or assets, or time needed to sell the equipment would require us to record a write-down. This would lower net income. Impaired finance receivables and assets received to satisfy receivables (repossessed equipment) totaled $15.5 million (0.8% of finance receivables) at January 31, 2007.

Residual values

We record residual values on direct financing leases at the lowest of (i) any stated purchase option (ii) the present value at the end of the initial lease term of rentals due under any renewal options or (iii) our projection of the equipment's fair value at the end of the lease. We may not fully realize recorded residual values because of unexpected adverse changes in or incorrect projections of future equipment values. This would lower net income. Residual values totaled $41.3 million (2.0% of finance receivables) at January 31, 2007. Historically, we have realized the recorded residual value on disposition.

Stock-based compensation

We record compensation expense for stock options under SFAS No. 123R using the Black-Scholes option pricing model. This model requires us to estimate the expected volatility of the price of our common stock, the expected life of options and the expected dividend rate. SFAS No. 123R also requires us to estimate forfeitures of stock awards. Estimating volatility, expected life,

dividend rate and forfeitures requires significant judgment and an analysis of historical data. If actual results differ from our estimates significantly, compensation expense for options and shares of restricted stock and our results of operations could be impacted materially.

RESULTS OF OPERATIONS

Comparison of three months ended January 31, 2007 to three months ended January 31, 2006

($ in millions, except per share amounts)	Three Months Ended January 31, 2007	2006	$ Change	% Change
Finance income	$47.4	$39.4	$ 8.0	20%
Interest expense	21.1	16.0	5.1	31
Net finance income before provision for credit losses	26.3	23.4	2.9	12
Provision for credit losses	--	--	--	--
Salaries and other expenses	6.1	5.8	0.3	7
Provision for income taxes	7.8	6.9	0.9	13
Net income	12.4	10.7	1.7	16
Diluted earnings per share	0.46	0.41	0.05	12
Basic earnings per share	0.47	0.42	0.05	12

Net income increased by 16% to $12.4 million in the second quarter of fiscal 2007 from $10.7 million in the second quarter of fiscal 2006. The increase resulted from receivables growth and the higher net yield on finance receivables, partially offset by the effects of higher short-term market interest rates and higher salary expense.

Finance income increased by 20% to $47.4 million in the second quarter of fiscal 2007 from $39.4 million in the second quarter of fiscal 2006. The increase resulted from the 15% increase in average finance receivables ($268.0 million) to $2.05 billion in the second quarter of fiscal 2007 from $1.78 billion in the second quarter of fiscal 2006 and, to a lesser extent, the higher net yield on finance receivables. Higher market interest rates raised the net yield on finance receivables to 9.17% in the second quarter of fiscal 2007 from 8.78% in the second quarter of fiscal 2006.

Interest expense (incurred on debt used to fund finance receivables) increased by 31% to $21.1 million in the second quarter of fiscal 2007 from $16.0 million in the second quarter of fiscal 2006. The increase resulted from higher average short-term market interest rates and the 15% ($209.0 million) increase in average debt. Increases in short-term market interest rates raised our weighted-average cost of debt to 5.36% in the second quarter of fiscal 2007 from 4.72% in the second quarter of fiscal 2006.

Net finance income before provision for credit losses on finance receivables increased by 12% to $26.3 million in the second quarter of fiscal 2007 from $23.4 million in the second quarter of fiscal 2006. Net interest margin (net finance income before provision for credit losses expressed as an annualized percentage of average finance receivables) decreased to 5.09% in the second quarter of fiscal 2007 from 5.21% in the second quarter of fiscal 2006

because the yield curve was inverted. This is discussed in the Market Interest Rate Risk and Sensitivity section.

We did not record provisions for credit losses on finance receivables in the second quarter of fiscal 2007 and 2006. The provision for credit losses is the amount needed to change the allowance for credit losses to our estimate of losses inherent in finance receivables. We did not need to increase the allowance because of continued low amounts of quarterly net charge-offs and continued strong asset quality, and we did not need to reduce it because of receivables growth. In the second quarter of fiscal 2007, there was a $101,000 net recovery (recoveries exceeded write-downs of finance receivables) compared to $72,000 of net charge-offs (write-downs of finance receivables less recoveries) in the second quarter of fiscal 2006, and the loss ratio (net charge-offs (recoveries) expressed as an annualized percentage of average finance receivables) was (0.02)% in the second quarter of fiscal 2007 and 0.02% in the second quarter of 2006.

Salaries and other expenses increased by 7% to $6.1 million in the second quarter of fiscal 2007 from $5.8 million in the second quarter of fiscal 2006. The increase resulted from salary increases and an increase in the number of employees. The expense ratio (salaries and other expenses expressed as an annualized percentage of average finance receivables) improved to 1.19% in the second quarter of fiscal 2007 from 1.28% in the second quarter of fiscal 2006 because the percentage increase in receivables exceeded the percentage increase in expenses. The efficiency ratio (expense ratio expressed as a percentage of net interest margin) improved to 23.3% in the second quarter of fiscal 2007 from 24.6% in the

second quarter of fiscal 2006 because the percentage increase in net finance income before provision for credit losses exceeded the percentage increase in expenses.

The provision for income taxes increased to $7.8 million in the second quarter of fiscal 2007 from $6.9 million in the second quarter of fiscal 2006. The increase resulted from the increase in income before income taxes, partially offset by the decrease in our effective tax rate to 38.5% in the second quarter of fiscal 2007 from 39.2% in the second quarter of fiscal 2006. Our effective tax rate decreased because of the new Texas income tax law enacted in our fourth quarter of fiscal 2006 and effective for fiscal 2007, and the overall decrease in our state effective income tax rate.

Diluted earnings per share increased by 12% to $0.46 per share in the second quarter of fiscal 2007 from $0.41 per share in the second quarter of fiscal 2006, and basic earnings per share increased by 12% to $0.47 per share in the second quarter of fiscal 2007 from $0.42 per share in the second quarter of fiscal 2006. The percentage increases in diluted and basic earnings per share were lower than the percentage increase in net income because of stock option exercises.

Comparison of six months ended January 31, 2007 to six months ended January 31, 2006

($ in millions, except per share amounts)	Six Months Ended January 31, 2007	2006	$ Change	% Change

Finance income	$94.3	$76.0	$18.3	24%
Interest expense	42.0	30.3	11.7	39
Net finance income before provision for credit losses	52.3	45.7	6.6	15
Provision for credit losses	--	--	--	--
Salaries and other expenses	12.2	11.3	0.9	9
Provision for income taxes	15.5	13.4	2.1	15
Net income	24.6	21.0	3.6	17
Diluted earnings per share	0.92	0.80	0.12	15
Basic earnings per share	0.94	0.81	0.13	16

Net income increased by 17% to $24.6 million in the first half of fiscal 2007 from $21.0 million in the first half of fiscal 2006. The increase resulted from receivables growth and the higher net yield on finance receivables, partially offset by the effects of higher short-term market interest rates and higher salary expense.

Finance income increased by 24% to $94.3 million in the first half of fiscal 2007 from $76.0 million in the first half of fiscal 2006. The increase resulted from the 17% increase in average finance receivables ($292.0 million) to $2.04 billion in the first half of fiscal 2007 from $1.74 billion in the first half of fiscal 2006 and, to a lesser extent, the higher net yield on finance receivables. Higher market interest rates raised the net yield on finance receivables to 9.19% in the first half of fiscal 2007 from 8.65% in the first half of fiscal 2006.

Interest expense increased by 39% to $42.0 million in the first half of fiscal 2007 from $30.3 million in the first half of fiscal 2006. The increase resulted from higher average short-term market interest rates and the 18% ($232.0 million) increase in average debt. Increases in short-term market interest rates raised our weighted-average cost of debt to 5.37% in the first half of fiscal 2007 from 4.56% in the first half of fiscal 2006.

Net finance income before provision for credit losses on finance receivables increased by 15% to $52.3 million in the first half of fiscal 2007 from $45.7 million in the first half of fiscal 2006. Net interest margin decreased to 5.10% in the first half of fiscal 2007 from 5.20% in the first half of fiscal 2006 because the yield curve was inverted.

We did not record provisions for credit losses on finance receivables in the first half of fiscal 2007 and 2006. We did not need to increase the allowance because of continued low amounts of quarterly net charge-offs and continued strong asset quality, and we did not need to reduce it because of receivables growth. In the first half of fiscal 2007, there was a $48,000 net recovery compared to $109,000 of net charge-offs in the first half of fiscal 2006, and the loss ratio was (0.01)% in the first half of fiscal 2007 and 0.01% in the first half of 2006.

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Salaries and other expenses increased by 9% to $12.2 million in the first half of fiscal 2007 from $11.3 million in the first half of fiscal 2006. The increase resulted from salary increases and an increase in the number of employees. The expense ratio improved to 1.19% in the first half of fiscal 2007 from 1.28% in the first half of fiscal 2006 because the percentage increase in receivables exceeded the percentage increase in expenses. The efficiency ratio improved to 23.4% in the first half of fiscal 2007 from 24.6% in the first half of fiscal 2006 because the percentage increase in net finance income before

provision for credit losses exceeded the percentage increase in expenses.

The provision for income taxes increased to $15.5 million in the first half of fiscal 2007 from $13.4 million in the first half of fiscal 2006. The increase resulted from the increase in income before income taxes, partially offset by the decrease in our effective tax rate to 38.6% in the first half of fiscal 2007 from 39.1% in the first half of fiscal 2006. Our effective tax rate decreased because of the new Texas income tax law enacted in our fourth quarter of fiscal 2006 and effective for fiscal 2007, and the overall decrease in our state effective income tax rate.

Diluted earnings per share increased by 15% to $0.92 per share in the first half of fiscal 2007 from $0.80 per share in the first half of fiscal 2006, and basic earnings per share increased by 16% to $0.94 per share in the first half of fiscal 2007 from $0.81 per share in the first half of fiscal 2006. The percentage increases in diluted and basic earnings per share were lower than the percentage increase in net income because of stock option exercises.

FINANCE RECEIVABLES AND ASSET QUALITY

We discuss trends and characteristics of our finance receivables and our approach to managing credit risk in this section. The key aspect is asset quality. Asset quality statistics measure our underwriting standards, skills and policies and procedures and can indicate the direction and levels of future net charge-offs and non-performing assets.

($ in millions)	January 31, 2007*	July 31, 2006*	$ Change	% Change
Finance receivables	$2,050.9	$1,991.7	$ 59.2	3%
Allowance for credit losses	24.1	24.1	--	--
Non-performing assets	15.5	14.6	0.9	6
Delinquent finance receivables	8.3	8.6	(0.3)	(4)
Net charge-offs (recoveries) (below $50,000)	--	--	--	--
As a percentage of receivables:				
Allowance for credit losses	1.18%	1.21%		
Non-performing assets	0.76	0.73		
Delinquent finance receivables	0.40	0.43		
Net charge-offs (recoveries)	--	--		

* as of and for the six months ended

Finance receivables grew 3% ($59 million) during the first half of fiscal 2007 to $2.05 billion at January 31, 2007 from $1.99 billion at July 31, 2006. Finance receivables comprise installment sale agreements and secured loans (collectively referred to as loans) and direct financing leases. Loans were 90% ($1.85 billion) of finance receivables and leases were 10% ($203 million) at January 31, 2007.

Finance receivables originated in the second quarter of fiscal 2007 and 2006 were $284 million and $325 million, respectively, and finance receivables originated in the first half of fiscal 2007 and 2006 were $604 million and $648 million, respectively. Originations decreased because the strong demand for

equipment financing eased due to general economic conditions and reduced demand for transportation equipment financing. A government mandated engine change effective in 2007 may have prompted truck buyers to accelerate purchases in prior fiscal quarters. Finance receivables collected in the second quarter of fiscal 2007 and 2006 were $275 million and $253 million, respectively, and finance receivables collected in the first half of fiscal 2007 and 2006 were $538 million and $496 million, respectively. Collections increased because of higher average receivables.

Our primary focus is the credit quality of our receivables. We manage our credit risk by using disciplined and sound underwriting policies and procedures, by monitoring our receivables closely and by handling non-performing accounts effectively. Our underwriting policies and procedures require a first lien on equipment financed. We focus on financing

equipment with an economic life longer than the term financed, historically low levels of technological obsolescence, use in more than one type of business, ease of access and transporting, and broad, established resale markets. Securing our receivables with equipment possessing these characteristics can mitigate potential net charge-offs. We may also obtain additional equipment or other collateral, third-party guarantees, advance payments or hold back a portion of the amount financed. We do not finance or lease aircraft or railcars, computer related equipment, telecommunications equipment or equipment located outside the United States, and we do not lend to consumers.

Our underwriting policies limit our credit exposure with any single customer. This limit was $38.0 million at January 31, 2007. Our ten largest customers accounted for 6.0% ($124.0 million) of total finance receivables at January 31, 2007.

Our allowance for credit losses was $24.1 million at January 31, 2007 and July 31, 2006. The allowance level declined to 1.18% of finance receivables at January 31, 2007 from 1.21% at July 31, 2006 because of continued low net charge-offs, favorable asset quality and receivables growth. We determine the allowance quarterly based on our analysis of historical losses and the past due status of receivables at the end of each quarter adjusted for expected recoveries and any differences between current and historical loss trends and other factors.

In the first six months of fiscal 2007, there was a $48,000 net recovery (recoveries exceeded write-downs of finance receivables) compared to $16,000 of net charge-offs (write-downs less recoveries) in the last six months of fiscal 2006 (the prior six month period). There was a $101,000 net recovery in the second quarter of fiscal 2007 compared to $53,000 of net charge-offs in the first quarter of fiscal 2007 with loss ratios of (0.01)% and 0.01%, respectively. Net charge-offs remained low because of low non-performing assets.

The net investments in non-accrual (impaired) finance receivables, repossessed equipment (assets received to satisfy receivables), total non-performing assets and delinquent finance receivables (transactions with more than a nominal portion of a contractual payment 60 or more days past due) follow ($ in millions):

	January 31, 2007	July 31, 2006	January 31, 2006
Non-accrual finance receivables *	$13.5	$13.8	$11.6

Repossessed equipment	2.0	0.8	0.7
Total non-performing assets	$15.5	$14.6	$12.3
Delinquent finance receivables	$ 8.3	$ 8.6	$ 9.1
Percentage of non-accrual receivables not delinquent	62%	54%	60%

* before specifically allocated allowance of $0.2 million at January 31, 2007, $0.3 million at July 31, 2006 and $0.4 million at January 31, 2006

Our asset quality statistics stayed at favorable levels during the quarter. Net charge-offs, non-accrual receivables, repossessed equipment and delinquencies were far below expected levels. Therefore, we do not expect further improvement in these measures and moderate increases would not necessarily indicate the start of a negative trend. The increase in repossessed equipment is an example of such a moderate increase. Also, because our asset quality statistics are far below expected levels, they could worsen significantly if receivables from our larger customers become delinquent, impaired or repossessed even though the overall trend may remain positive.

LIQUIDITY AND CAPITAL RESOURCES

We describe our need for raising capital (debt and equity), our need for having a substantial amount of liquidity (money currently available for us to borrow), our approach to managing liquidity and our current funding sources in this section. Key indicators are leverage (the number of times debt exceeds equity), available liquidity, credit ratings and debt diversification. Our leverage is low for a finance company, we have been successful in issuing debt, we have ample liquidity available and our debt is diversified with maturities staggered over five years.

Liquidity and access to capital are vital to our operations and growth. We need continued availability of funds to originate or acquire finance receivables and to repay debt. To ensure we have enough liquidity, we project our financing

needs based on estimated receivables growth and maturing debt, we monitor capital markets closely and we diversify our funding sources. Funding sources available to us include operating cash flow, private and public issuances of term debt, conduit and term securitizations of finance receivables, committed unsecured revolving bank credit facilities, dealer placed and direct issued commercial paper and sales of common and preferred equity. We believe our liquidity sources are diversified, and we are not dependent on any funding source or provider.

Our term notes are rated 'BBB+' by Fitch Ratings, Inc. ("Fitch", a Nationally Recognized Statistical Ratings Organization) and our commercial paper is rated 'F2' by Fitch. As a condition of our 'F2' credit rating, commercial paper outstanding is limited to the unused amount of our bank credit facilities. Fitch affirmed its investment grade ratings on our debt in January 2007 maintaining its stable outlook. Our access to capital markets and our credit spreads are partly dependent on these investment grade credit ratings.

We had $170.3 million available to borrow under our bank credit facilities (after subtracting commercial paper outstanding) at January 31, 2007. Our asset

securitization facility could be increased by $341.0 million and we believe we can issue more term notes. We believe, but cannot assure, sufficient capital is available to us to sustain our future operations and growth.

Our major operating subsidiary's debt agreements have restrictive covenants including limits on its indebtedness, encumbrances, investments, dividends and other distributions to us, sales of assets, mergers and other business combinations, capital expenditures, interest coverage and net worth. We were in compliance with all debt covenants at January 31, 2007. None of the agreements have a material adverse change clause.

Debt increased by 1% ($22.7 million) to $1.55 billion at January 31, 2007 from $1.53 billion at July 31, 2006 and stockholders' equity increased by 6% ($25.0 million) to $415.4 million at January 31, 2007 from $390.4 million at July 31, 2006. Leverage remained low at 3.7 allowing for substantial asset growth. Historically, our leverage has not exceeded 5.5 which is also considered low for a finance company.

Debt comprised the following ($ in millions):

	January 31, 2007		July 31, 2006	
	Amount	Percent	Amount	Percent
Term notes	$ 629.5	41%	$ 664.5	43%
Asset securitization financings	425.0	27	425.0	28
Commercial paper	297.2	19	118.9	8
Convertible debentures	175.0	11	175.0	11
Borrowings under bank credit facilities	27.5	2	149.7	10
Total principal	1,554.2	100%	1,533.1	100%
Fair value adjustment of hedged debt	(3.8)		(5.4)	
Total debt	$1,550.4		$1,527.7	

Term Notes

We repaid $25.0 million of 5.92% fixed rate term notes at maturity and we converted a $10.0 million floating rate term note from a bank due in fiscal 2008 to a $15.0 million three-year committed unsecured revolving credit facility in the first half of fiscal 2007.

Asset Securitization Financings

We have a $425.0 million asset securitization facility. We established the facility in July 2001. The facility was renewed a fifth time in April 2006 and expires in April 2007 subject to further renewal. The facility limits borrowings to a minimum level of securitized receivables. If borrowings exceed the minimum level, we must repay the excess or securitize more receivables. We can securitize more receivables during the term of the facility. On expiration and nonrenewal of the facility, we must repay borrowings outstanding or convert them into term debt. The term debt would be repaid monthly and would be fully repaid by August 2009 based on the contractual payments of the $475.0 million of securitized receivables at January 31, 2007.

The unsecured debt agreements of our major operating subsidiary allow 40%

of its finance receivables to be securitized ($816.0 million at January 31, 2007). Therefore, we could securitize an additional $341.0 million of finance receivables at January 31, 2007. Borrowings are limited to 94% of securitized receivables and can be further limited based on the eligibility of securitized receivables.

Convertible Debentures

The convertible debentures were convertible into 6.1 million shares (as adjusted) of common stock at the adjusted conversion price of $28.53 per share resulting in an adjusted conversion rate of 35.05 shares for each $1,000 of principal until we irrevocably elected in fiscal 2005 to pay the value of converted debentures, not exceeding the principal amount, in cash instead of issuing shares of our common stock. As a result, the 6.1 million convertible shares are no longer issuable upon conversion, but we would need to issue shares of common stock to pay any value over principal. The value of the convertible debentures equals the number of convertible shares multiplied by the market value of our common stock. No event allowing for the debentures to be converted has occurred through January 31, 2007.

Bank Credit Facilities

We have $495.0 million of committed unsecured revolving credit facilities from ten banks (a $25.0 million increase from July 31, 2006). This includes $307.5 million of facilities with original terms ranging from two to five years and $187.5 million of facilities with an original term of one year. Borrowings under these facilities can mature between 1 and 270 days. We can borrow the full amount under each facility. These facilities may be renewed or extended before they expire.

Commercial Paper

We issue commercial paper direct and through a $500.0 million program with maturities between 1 and 270 days. We increased the size of our commercial paper program in the second quarter of fiscal 2007 from $350.0 million. The combined amount of commercial paper and bank borrowings ($324.7 million January 31, 2007) was limited to $495.0 million because commercial paper outstanding is limited to the unused amount of our bank credit facilities. Commercial paper outstanding increased during the first half of fiscal 2007 because we added a commercial paper dealer.

Stockholders' Equity

We paid $6.8 million of cash dividends, we received $3.5 million from stock option exercises and tax benefits from stock-based awards and we repurchased 5,000 shares of common stock for $134,000 in the first half of fiscal 2007. At January 31, 2007, $17.4 million was available for future repurchases under our repurchase program.

MARKET INTEREST RATE RISK AND SENSITIVITY

We discuss how changes in market interest rates affect our net interest spread and how we manage interest rate risk in this section. Net interest spread (the net yield of finance receivables less the weighted-average cost of debt) is an integral part of a finance company's profitability and is calculated below:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2007	2006	2007	2006
Net yield of finance receivables	9.17%	8.78%	9.19%	8.65%
Weighted-average cost of debt	5.36	4.72	5.37	4.56
Net interest spread	3.81%	4.06%	3.82%	4.09%

Our net interest spread was 0.25% (25 basis points) lower in the second quarter of fiscal 2007 compared to the second quarter of fiscal 2006, and was 0.27% (27 basis points) lower in the first half of fiscal 2007 compared to the first half of fiscal 2006 because the effects of higher average short-term market interest rates exceeded the increase in the net yield of finance receivables. This is an expected result of an inverted yield curve as discussed below.

Our net interest spread is sensitive to changes in short-term and long-term market interest rates (includes LIBOR, rates on U.S. Treasury securities, money-market rates, swap rates and the prime rate). Increases in short-term rates reduce our net interest spread (this occurred during our prior two fiscal years) and decreases in short-term rates increase our net interest spread because our floating rate debt (includes short-term debt) exceeds our floating rate finance receivables by a significant amount. Interest rates on our debt change faster than the yield on our receivables because 57% of our debt is floating rate compared to floating rate finance receivables of only 7%. Our net interest spread is also affected when the differences between short-term and long-term rates change. Long-term rates normally exceed short-term rates. When this excess narrows (resulting in a "flattening yield curve") or when short-term rates exceed long-term rates (an "inverted yield curve"), our net interest spread should decrease and when the yield curve widens our net interest spread should increase because the rates we charge our customers are partially determined by long-term market interest rates and rates on our

floating rate debt are largely determined by short-term market interest rates. We can mitigate the effects of an inverted yield curve by issuing long-term fixed rate debt.

Short-term market interest rates changed little during the first half of fiscal 2007 after rising substantially and consistently over the prior two years. As a result, our weighted-average cost of debt decreased by 0.01% (1 basis point) in the second quarter of fiscal 2007 compared to quarterly increases of 0.25% (25 basis points) during the prior two fiscal years. Our weighted-average cost of debt only increased by 0.10% (10 basis points) during the first half of fiscal 2007.

Our income is subject to the risk of rising short-term market interest rates and an inverted yield curve at January 31, 2007 because floating rate debt exceeded floating rate receivables by $739.8 million (see the table below). The terms and prepayment experience of our fixed rate receivables mitigate this risk. Finance receivables are collected monthly over short terms of two to five years and have been accelerated by prepayments. At January 31, 2007, $683.0

million (36%) of fixed rate finance receivables are scheduled to be collected in one year and the weighted-average remaining life of fixed rate finance receivables excluding prepayments is approximately twenty months. We do not match the maturities of our debt to our finance receivables. The fixed and floating rate amounts and percentages of our finance receivables and capital at January 31, 2007 follow ($ in millions):

	Fixed Rate		Floating Rate		
	Amount	Percent	Amount	Percent	Total
Finance receivables	$1,897.8	93%	$153.1	7%	$2,050.9
Debt (principal)	$ 661.3	43%	$892.9	57%	$1,554.2
Stockholders' equity	415.4	100	--	--	415.4
Total debt and equity	$1,076.7	55%	$892.9	45%	$1,969.6

Floating rate debt comprises asset securitization financings, commercial paper, floating rate swaps of fixed rate notes and bank borrowings, and reprices (interest rate changes based on current short-term market interest rates) at January 31, 2007 as follows: $671.2 million (75%) within one month, $187.4 million (21%) in two to three months and $34.3 million (4%) in four to six months. Most of the floating rate swaps of fixed rate notes last repriced in October 2006. The repricing frequency of floating rate debt follows (in millions):

	Balance	Repricing Frequency
Asset securitization financings	$425.0	generally daily
Commercial paper	297.2	1 to 90 days (20 day average)
Floating rate swaps of fixed rate notes	143.3	semiannually (120 day average)
Bank borrowings	27.5	generally daily

We quantify interest rate risk by calculating the effect on net income of a hypothetical, immediate 100 basis point (1.0%) rise in market interest rates. This hypothetical change in rates would reduce quarterly net income by approximately $0.5 million at January 31, 2007 based on scheduled repricings of floating rate debt, fixed rate debt maturing within one year and the expected effects on the yield of new receivables. This amount increases to $1.0 million excluding the expected increase in the yield of new receivables. We believe these amounts are acceptable considering the cost of floating rate debt has been historically lower than fixed rate debt. Actual future changes in market interest rates and the effect on net income may differ materially from these amounts. Other factors that may accompany an actual immediate 100 basis point rise in market interest rates were not considered in the calculation.

We monitor and manage our exposure to potential adverse changes in market interest rates by using certain derivative financial instruments and by changing the proportion of our fixed and floating rate debt. We may use derivatives to hedge our exposure to interest rate risk on existing debt and debt expected to be issued. We do not speculate with or trade derivatives.

We entered into interest rate locks with a total notional amount of $100.0 million with three counterparty banks in September 2006 to lock-in the interest rate on our anticipated issuance of $100.0 million of five-year fixed rate term notes. The rate locks had a March 2007 expiration. We designated the rate locks as cash flow hedges of an anticipated issuance of five-year fixed rate term notes hedging the risk of interest rate changes, on the interest payments of the notes, through the date the interest rate is set on the note issuance. We terminated the rate locks in January 2007 and realized a $1.0 million

gain. This cash flow hedge gain was recorded in stockholders' equity as accumulated other comprehensive income net of deferred income tax of $0.4 million, and will be reclassified into net income by reducing interest expense and deferred income taxes over the five-year term of the notes expected to be issued in our third quarter of fiscal 2007.

We also have fixed to floating interest rate swaps with a total notional amount of $143.3 million at January 31, 2007 and July 31, 2006. The swaps effectively converted fixed rate term notes into floating rate term notes. Semiannually, we receive fixed amounts from the swap counterparty banks equal to the interest we pay on the hedged fixed rate notes, and we pay amounts to the swap counterparty banks equal to the swaps' floating rates multiplied by the swaps' notional amounts. The swaps' floating rates change every six months to a fixed amount over six-month LIBOR (5.40% at January 31, 2007). The swaps increased interest expense by $0.8 million in the second quarter of fiscal 2007 and by $1.5 million in the first half of fiscal 2007. The weighted-average pay rate of 6.93% at January 31, 2007 exceeded the 4.88% weighted-average receive rate 205 basis points (2.05%). The weighted-average remaining term of the swaps at January 31, 2007 is 1.5 years.

NEW ACCOUNTING STANDARDS

The Financial Accounting Standards Board ("FASB") issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB 109", ("FIN No. 48") in July 2006. FIN No. 48 requires companies to determine if any tax positions taken on their income tax returns lowering the amount of tax currently due would more likely than not be allowed by a taxing jurisdiction. If tax positions pass the more-likely-than-not test, companies then record benefits from them only equal to the highest amount that has a greater than 50% chance of being realized assuming the tax positions would be challenged by a taxing jurisdiction. No benefits would be recorded for tax positions failing the more-likely-than-not test. Tax benefits include income tax savings and the related interest expense savings. Whether tax positions pass the test or not, adopting FIN No. 48 could result in additional income tax provisions or expenses for any interest and penalties on potential underpayments of income tax, or both. FIN No. 48 is effective in the first quarter of fiscal years beginning after December 15, 2006. It will become effective for us on August 1, 2007, the beginning of our fiscal year ending July 31, 2008. We are evaluating how it may affect our consolidated financial statements.

The FASB issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements", ("SFAS No. 157") in September 2006. SFAS No. 157 defines fair value (replacing all prior definitions) and creates a framework to measure fair value, but does not create any new fair value measurements. SFAS No. 157 is effective in the first quarter of fiscal years beginning after November 15, 2007. It will become effective for us on August 1, 2008. We are evaluating how it may affect our consolidated financial statements.

The FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115" in February 2007. SFAS No. 159 permits companies to choose to measure many financial instruments and certain other items at fair value at specified election dates and to report unrealized gains and losses on these items in earnings at each subsequent reporting date. SFAS No. 159 is effective in the first quarter of fiscal years beginning after November 15, 2007. It will become effective for us on August 1, 2008. We are evaluating how it may affect our consolidated financial statements.

FORWARD-LOOKING STATEMENTS

Statements in this report including the words or phrases "can be," "expect," "anticipate," "may," "believe," "estimate," "intend," "could," "should," "would," "if" and similar words and phrases are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are subject to various known and unknown risks and uncertainties and any forward-looking information provided by us or on our behalf is not a guarantee of future performance. Our actual results could differ from those anticipated by forward-looking statements materially because of the uncertainties and risks described in "Part I, Item 1A Risk Factors" in our Annual Report on Form 10-K for the year ended July 31, 2006 and other sections of this report. These risk factors include (i) an economic slowdown (ii) the inability to collect finance receivables and the sufficiency of the allowance for credit losses (iii) the inability to obtain capital or maintain liquidity (iv) rising short-term market interest rates and adverse changes in the yield curve (v) increased competition (vi) the inability to retain key employees and (vii) adverse conditions in the construction and road transportation industries. Forward-looking statements apply only as of the date made and we are not required to update forward-looking statements for future or unanticipated events or circumstances.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

See the Market Interest Rate Risk and Sensitivity Section in Part I, Item 2.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Our management (with our Chief Executive Officer's and Chief Financial Officer's participation) evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) at the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded our disclosure controls and procedures are effective to ensure information required to be disclosed in reports we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported timely.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the second quarter of fiscal 2007 that materially affected or are

reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

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

ISSUER PURCHASES OF EQUITY SECURITIES
For the Quarter Ended January 31, 2007

Month	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
November 2006	2,364	$27.03	2,364	$17,403,000

We did not sell any unregistered shares of common stock during the second quarter of fiscal 2007. We received 2,364 shares of common stock from our CEO in November 2006 as payment of income taxes we were required to withhold on vested shares of restricted stock. We established our common stock repurchase program in August 1996 and expanded it in August 1998 to include repurchases of convertible debt. A total of $40.7 million was authorized for repurchases of common stock and convertible debt and we repurchased $16.1 million of common stock and $7.2 million of convertible debt through January 31, 2007.

Item 4. Submission of Matters To a Vote of Security Holders

Our stockholders voted on the following at our December 6, 2006 Annual Meeting of Stockholders:

The following nominees were elected to the Board of Directors:

	Number of Votes	
Nominee	For	Withheld
Lawrence B. Fisher	24,268,095	1,816,038
Michael C. Palitz	16,621,410	9,462,723
Paul R. Sinsheimer	25,393,312	690,821
Leopold Swergold	25,691,728	392,405
H. E. Timanus, Jr.	25,673,326	410,807
Michael J. Zimmerman	25,673,326	410,807

The appointment of KPMG LLP as our independent registered public accounting firm for our fiscal year ending July 31, 2007 was ratified by a vote

of 26,037,569 shares for, 37,598 shares against and 8,966 shares abstained. The Amended and Restated 2001 Management Incentive Plan was approved by a vote of 23,909,771 shares for, 782,046 shares against and 36,682 shares abstained. The 2006 Stock Incentive Plan was approved by a vote of 15,155,389 shares for, 9,534,414 shares against and 38,696 shares abstained.

Item 5. Other Information

We issued a press release on March 5, 2007 reporting our results for the quarter ended January 31, 2007. The press release is attached as Exhibit 99.1. Exhibit 99.1 shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), or subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference.

We issued a press release on March 5, 2007 announcing our Board of Directors declared a quarterly dividend of $0.15 per share on our common stock and increased the amount available under our common stock and convertible debt repurchase program to $20.0 million from $17.4 million. The press release is attached as Exhibit 99.2. The dividend is payable on April 10, 2007 to stockholders of record at the close of business on March 22, 2007. The dividend rate is the same as the previous quarter.

We amended and restated our bylaws on March 5, 2007 to provide us with the authority to issue book entry or uncertificated shares in lieu of share certificates for all classes or series of stock and to provide for the transfer of these shares. Our Amended and Restated By-laws is attached as Exhibit 3.3.

Item 6. Exhibits

Exhibit No.		Description of Exhibit
3.1	(a)	Articles of Incorporation
3.2	(b)	Certificate of Amendment of Articles of Incorporation dated December 9, 1998
3.3		Amended and Restated By-laws dated March 5, 2007
10.19	(c)	Amended and Restated 2001 Management Incentive Plan
10.20	(c)	2006 Stock Incentive Plan
31.1		Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer
31.2		Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer
32.1		Section 1350 Certification of Chief Executive Officer
32.2		Section 1350 Certification of Chief Financial Officer
99.1		Press release dated March 5, 2007
99.2		Press release dated March 5, 2007

Previously filed with the Securities and Exchange Commission as an exhibit to our:

(a) Registration Statement on Form S-1 (Registration No. 33-46662) filed May 28, 1992
(b) Form 10-Q for the quarter ended January 31, 1999
(c) Form 8-K dated December 6, 2006

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
Vice President and Controller
(Principal Accounting Officer)

March 8, 2007
(Date)