NowAuto Group, Inc.
Form 10-Q
February 22, 2011

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

FORM 10-Q

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

For the quarterly period ended December 31, 2010
Commission File Number 000-50709

NOWAUTO GROUP, INC.
(Exact name of registrant as specified in its charter)

Nevada	77-0594821
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

4240 East Elwood Street, Phoenix, Arizona 85040
(Address of principal executive offices) (Zip Code)
Registrant's Telephone Number: (480) 431-0015

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. x Yes o No

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

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

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o	Smaller reporting company x

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

Indicate the number of shares outstanding of each of the registrant’s classes of common stock, as of the latest practicable date:

As of February 15, 2011 there were 9,383,046 shares, net of treasury shares, of common stock outstanding.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

NowAuto Group, Inc
Condensed Consolidated Balance Sheets

Assets

		December 31, 2010 (Unaudited)	June 30, 2010
Assets			
Cash and Cash Equivalents	$	56,912	54,551
Investment in sales-type leases, net		4,131,287	4,085,136
Investment in purchased contracts, net		307,576	-
Inventory		128,835	118,365
Prepaid Expenses		62,342	26,194
Equipment - net		36,160	53,094
Total Assets	$	4,723,112	4,337,340
Liabilities and Stockholders' Deficit			
Liabilities			
Accounts Payable	$	192,137	253,553
Line of Credit		13,782,778	12,327,572
Accrued Payroll		233,380	129,523
Other Liabilities		49,581	39,563
Total Liabilities		14,257,876	12,750,211
Stockholders' Deficit			
Common Stock, authorized 1,000,000,000 shares $0.001 par value; 9,843,046 shares Issued and 9,383,046 share outstanding as of December 31, 2010 and June 30, 2010		9,843	9,843
Paid in Capital		4,649,931	4,649,931
Accumulated Deficit		(14,167,039)	(13,045,146)
		(9,507,265)	(8,385,372)
Less: treasury stock, 460,000 shares at cost as of December 31, 2010 and June 30, 2010 respectively		(27,499)	(27,499)
Total Stockholders' Deficit		(9,534,764)	(8,412,871)
Total Liabilities and Stockholders' Deficit	$	4,723,112	4,337,340

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

NowAuto Group, Inc
Condensed Consolidated Statements of Operations
(unaudited)

	3 Months Ended December 31, 2010 (Unaudited)	3 Months Ended December 31, 2009 (Unaudited)	6 Months Ended December 31, 2010 (Unaudited)	6 Months Ended December 31, 2009 (Unaudited)
Income				
Sales-type leases and other	$ 764,979	$ 1,185,780	1,586,018	$ 2,332,012
Finance Income	274,697	295,761	555,347	576,156
Total revenue	1,039,676	1,481,541	2,141,365	2,908,168
Cost of Goods Sold	386,172	682,143	794,460	1,374,630
Gross Profit	653,504	799,398	1,346,905	1,533,538
Gross Margin	62.9 %	54.0 %	62.9 %	52.7 %
Expenses				
Selling and Financing Costs	587,906	603,614	1,151,789	1,121,553
General and Administrative	376,128	461,461	733,658	868,668
Loss from Operations	(310,530)	(265,677)	(538,542)	(456,683)
Interest Expense	299,820	256,991	583,351	508,687
Net Loss	$ (610,350)	$ (522,668)	(1,121,893)	$ (965,370)
Basic and Diluted Loss per Share	$ (0.07)	$ (0.06)	$ (0.12)	$ (0.10)
Weighted Average Number of Common Shares Outstanding	9,383,046	9,383,046	9,383,046	9,383,046

The accompanying notes are an integral part of these condensed

consolidated
financial
statements.

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NowAuto Group, Inc
Condensed Consolidated Statements of Cash Flows

	6 Months Ended December 31, 2010		6 Months Ended December 31, 2009	
Operating Activities				
Net Loss	$	(1,121,893)	$	(965,370)
Adjustments to reconcile Net Loss to Net Cash used in Operating Activities				
Significant Non-Cash Transactions				
Depreciation/Amortization Expense		8,449		10,795
Loss on disposal of fixed assets		-		14,691
Interest expense capitalized into principal		583,351		508,687
Provision for uncollectible receivables		60,439		(230,974)
Changes in assets and liabilities				
Investment in sales-type leases		(106,590)		(471,496)
Investment in Purchased Contracts		(307,576)		
Inventory		(1,985)		66,420
Prepaid expenses		(36,148)		(40,121)
Accounts payable		(61,416)		154,183
Accrued Payroll		103,857		-
Other liabilities		10,018		6,559
		252,399		18,744
Net cash used in operating activities		(869,494)		(946,626)
Investing Activities				
Purchase of Fixed Assets		-		(4,705)
Net Cash used in Investing Activities		-		(4,705)
Financing Activities				
Proceeds from line of credit		2,313,828		2,755,335
Principal payments on line of credit		(1,441,973)		(1,789,241)
Net cash provided by Financing Activities		871,855		966,094
Net Increase in Cash and Cash Equivalents		2,361		14,763
Cash, Beginning of Period		54,551		40,610
Cash, End of Period	$	56,912	$	55,373
Supplemental Information:				
Period interest	$	-	$	-
Income Taxes paid	$	-	$	-

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

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NowAuto Group, Inc.
Notes to the Condensed Consolidated Financial Statements (Unaudited)

Note 1. Nature of Operations and Significant Accounting Policies

Nature of Operations

NowAuto Group, Inc. primarily leases vehicles in the Buy Here, Pay Here industry through the use of sales-type leases. Our customers are individuals with sub-prime credit histories. We currently operate primarily in the Phoenix, Arizona Metropolitan area. The company was originally formed as a Nevada Corporation and has been operating for the past six years.

General

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and in accordance with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by the accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months and six months ended December 31, 2010 are not necessarily indicative of the results that may be expected for the year ending June 30, 2011. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended June 30, 2010.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates. Material estimates that are susceptible to significant change in the near term include, but are not limited to, the determination of the allowance for doubtful accounts, the realization of deferred financing revenue, the residual value of leases, and the carrying value of inventory.

Concentration of Risk

We originate our contracts and provide financing in connection with the sale and/or lease of substantially all of our vehicles. Although we attempt to mitigate our exposure to credit risk through the use of employment checks, reference checks, proof of residence, and other procedures, failure of the customers to make scheduled payments under their lease contracts could have a material near term impact on our results of operations and financial condition. In addition, all of our financing is provided through our revolving credit agreement which is held by one privately controlled venture capital fund.

While we do have customers outside the Phoenix area, our customer base is concentrated in Phoenix. Therefore, economic factors influencing this area will also affect us.

Periodically, we maintain cash in financial institutions in excess of the amounts insured by the federal government.

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Cash Equivalents

We consider all highly liquid instruments purchased with initial maturities of three months or less to be cash equivalents.

Inventory

Inventory consists of used vehicles and is valued at the lower of cost or market on a specific identification basis. Vehicles purchased at auction, or wholesale, are typically recorded at their purchase price. Repossessed vehicles are recorded at the lesser of their original cash value or their fair value, which is determined based upon the approximate wholesale value. Vehicle reconditioning costs are capitalized as a component of inventory. The cost of used vehicles sold is determined using the specific identification method.

Equipment

Property and equipment are stated at cost. Expenditures for additions, renewals and improvements are capitalized. Costs of repairs and maintenance are expensed as incurred. Leasehold improvements are amortized over the shorter of the estimated life of the improvement or the lease period. The lease period includes the primary lease term plus any extensions that are reasonably assured. Depreciation is computed principally using the straight-line method generally over the following estimated useful lives:

Furniture, Fixtures and Equipment	3 to 7 years
Computer Equipment	3 to 5 years
Leasehold Improvements	Length of the lease, typically 1 – 3 years

Property and equipment are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying values of the impaired assets exceed the fair value of such assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Sales Tax

We pay sales taxes to local and state governmental agencies on vehicles sold and leased. For lease agreements, sales tax is paid when funds are received from the customer. Therefore, a liability is recorded for sales tax purposes in the period the lease payment is received from the customer. For sales contracts, calculations for sales taxes are made on an accrual basis. Vehicle repossessions are allowed as a deduction from taxable sales in the month of repossession. Customers often make their down payments in periodic increments over a period of four to six weeks. We do not report the sales for tax purposes until the down payments are fully paid. This is compliant with industry standards and with most state and local tax codes.

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates expected to apply in the years in which these temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance when in the opinion of management; it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Interest and penalties, if any, associated with unrecognized tax benefits, will be classified as additional income taxes in the statement of income.

We have adopted the provisions of Accounting Standards Codification 740-10. As of December 31, 2010, we had no liabilities, included on the consolidated balance sheets, associated with uncertain tax positions. We are still subject to examination of our financial statements, primarily for the last three years.

Sales-type leases

The Company's financing agreements are classified as sales-type leases pursuant to the provisions of Accounting Standards Codification - 840, Accounting for Leases. As such, revenues representing the sales price of the vehicles are recognized as income upon inception of the lease, with the resulting gross profit from the sales included in operations. Lease terms are typically for a period of 24 to 39 months with either monthly or bi-monthly payments.

The portion of revenues representing the difference between the gross investment in the lease (the sum of the minimum lease payments and the guaranteed residual value) and the sum of the present value of the two components is recorded as deferred revenue and amortized over the lease term. This deferred revenue represents the effective interest rate on the sales-type lease and ranges from approximately 18% to 29% per annum.

For the three months ended December 31, 2010 and 2009, amortization of deferred revenue totaled $274,697 and $295,761, respectively. For the six months ended December 31, 2010 and 2009, the total is 555,347 and 576,156.

Taxes assessed by governmental authorities that are directly imposed on revenue-producing transactions between the Company and its customers (which may include, but are not limited to, sales, use, value added and some excise taxes) are excluded from revenues.

Lessees are responsible for all taxes, insurance, and maintenance costs.

Investment in Purchase Contracts

During the quarter ended December 31, 2010 the Company commenced a new line of business which is comprised of purchasing pre-existing and third party point of sale auto loans from third party sources. These loans are purchased at a discount from the anticipated total future cash flow. As such, the loans are carried at cost under the category "Investment in purchased contracts, net", less amortization for the realization of the collection of the loans. Revenue is recognized under the effective interest rate method based on anticipated collections. As of December 31, 2010 these contracts are anticipated to be collected over approximately the next 18 months.

Repossessions

If the lessee ceases making payments pursuant to the lease terms and the decision is made by the Company to repossess the vehicle the lease is considered terminated. In such an event, the remaining balance of the lease is removed from the Investment in Sales-Type Leases, the repossessed vehicle is recorded as inventory at the lower of its original cost or its fair value at wholesale, and any resulting adjustment is charged to income during the period.

Advertising Costs

Advertising costs are expensed as incurred and consist principally of radio, television and print media marketing costs. Advertising costs amounted to $16,795 and $17,414 for the quarters ended December 31, 2010 and 2009, respectively; $36,546 and $38,587 for the six months ended December 31, 2010 and 2009, respectively.

Loss per Share

The loss per share ("EPS") is presented in accordance with the provisions of Accounting Standards Codification - 260. Basic EPS is calculated by dividing the income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Basic and diluted EPS were the same for the periods ended December 31, 2010 and 2009, as the Company had losses from operations during both periods and therefore the effect of all potential common stock equivalents is antidilutive (reduces loss per share). There were no warrants or options outstanding as of December 31, 2010.

Stock Option Plans

At December 31, 2010 we had no employee stock ownership plan.

Allowance for Delinquent Leases

Provisions for losses on leases in default are charged to operations in amounts sufficient to maintain the allowance for delinquent leases at a level considered adequate to cover probable credit losses.

The Company established the allowance for delinquent leases based on the determination of the amount of probable credit losses inherent in the finance receivables as of the reporting date. The Company reviews charge-off experience factors, delinquency reports, historical collection rates, estimates of the value of the underlying collateral, economic trends, such as unemployment rates, industry standards and other information in order to make the necessary judgments as to probable credit losses. Assumptions regarding probable credit losses and loss confirmation periods are reviewed periodically and may be impacted by actual performance of finance receivables and changes in any of the factors discussed above.

Residual Value of Leases

The estimate of residual value is a percent of the market value of the vehicle at the time of the lease. The percentage is based on the terms and, therefore, is intended to project the value of the vehicle at the end of the lease.

Note 2. Non-Classified Balance Sheet

We are a finance company, originating and financing all of our own leasing contracts, as well as buying other financing contracts. These contracts are 24 to 39 months in length. Therefore, our balance sheet is presented on a non-classified basis.

Note 3. Investment in Sales-Type Leases, net

The Company's leasing operations consist principally of leasing vehicles under sales-type leases expiring in various years to 2013. Following is a summary of the components of the Company's net investment in sales-type leases:

		December 31, 2010 (Unaudited)		June 30, 2010
Total Minimum Lease Payments to be Received	$	6,320,303	$	6,584,183
Residual Value		700,769		530,220
Lease Carrying Value		7,021,072		7,114,403
Less: Allowance for Uncollectible Amounts		(1,502,117)		(1,441,678)
Less: Unearned Income		(1,387,668)		(1,587,589)
Net Investment in Sales-Type Lease	$	4, 131,287	$	4,085,136

A schedule of future minimum lease payments for each of the next three years is estimated as follows:

Years Ending	
2011	$ 3,200,460
2012	2,308,185
2013	811,658
	$ 6,230,303

Note 4. Income Taxes

The significant components of the Company's deferred tax assets are as follows:

	December 31, 2010 (Unaudited)	June 30, 2010
Deferred tax assets		
Net operating loss carryforward	$ 4,463,700	$ 4,014,700
Less: valuation allowance	(4,463,700)	(4,014,700)
Deferred tax assets	$ -	$ -

At December 31, 2010, the Company has incurred accumulated net operating losses totaling approximately 11,158,000, which are available to reduce federal and state taxable income in future years through approximately 2030 for federal income.

Note 5. Line of Credit

As of December 31, 2010 the Company had a revolving credit agreement with a private equity fund. The credit agreement is secured by the lease or purchase contracts it agrees to fund, as well as the underlying vehicle. The monies advanced under the line of credit are based upon the contract price and vary per contract, at the discretion of the lender. Substantially all the sales-type lease contracts financed require our customers to make their monthly payments directly to the finance company via ACH (automatic account withdrawal). The Company retains ownership of the contracts and is active in the collection of delinquent accounts from the contracts. The line of credit matures and renews annually on February 6th. At inception, March 31, 2006, our credit limit was $3,000,000. This limit has been expanded by the lender to its current $14,000,000 limit. The interest rate is at the prime lending rate plus 6% (9.25% at December 31, 2010).

The revolving credit agreement has two debt covenants. The Company must maintain a tangible net worth of at least $2,000,000 and a leverage ratio that total liabilities cannot exceed four times the tangible net worth. As of December 31, 2010 we are not in compliance with either of these covenants. However we believe that we have a strong relationship with our lender and do not anticipate, without any assurance, that any collection actions are imminent.

Note 6. The Effect of Recently Issued Accounting Standards

The company does not expect the adoption of any accounting pronouncements issued since those disclosed in the company's annual report on Form 10-K for the year ended June 30, 2010 to have a significant impact on the company's results of operations, financial position or cash flow.

Note 7. Statement of Cash Flows

Non-Cash Investing and Financing Activities

The Company recognized investing and financing activities that affected assets and liabilities, but did not result in cash receipts or payments. These non-cash activities are as follows: During the six months ended December 31, 2010 the Company transferred two vehicles with a net book value of $8,485 from Property, plant and equipment to Inventory.

Note 7. Going Concern

The accompanying financial statements have been prepared assuming that we will continue as a going concern. We sustained a material loss in the year ended June 30, 2005 and continued to sustain material losses through December 31, 2010. This raises substantial doubt about our ability to continue as a going concern. The financial statements do not include any adjustments that might result from this uncertainty.

Since that initial loss, efforts have been made to improve our profitability. Margins on cars sold have increased. Costs, especially overhead, have been reduced. Head count is kept to a minimum. Accountability has been greatly enhanced by development of qualified Accounting staff and the implementation of an enterprise-wide and fully integrated software system. The Company has been and continues to develop the financing function whose focus includes, but is not limited to, improved stability scoring and credit approval process, improvement of the total portfolio aging, and reduction of account losses. In addition, the corporate office and Service Department relocated to the same facility. This new facility greatly enhances the Service Department's efficiency and capacity and gives upper management closer oversight of operations.

A detailed discussion of management's plans for dealing with this issue is in the Company's annual report on Form 10-K for the year ended June 30, 2010.

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

The following discussion should be read in conjunction with the Company's condensed consolidated financial statements and notes thereto appearing elsewhere in this report.

Forward-looking Information

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for certain forward-looking statements. Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company or its management) contain or will contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words "believe," "expect," "anticipate," "estimate," project" and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. The Company undertakes no obligation to publicly update or revise any forward-looking statements. Such forward-looking statements are based upon management's current plans or expectations and are subject to a number of uncertainties and risks that could significantly affect current plans, anticipated actions and the Company's future financial conditions and results. As a consequence, actual results may differ materially from those expressed in any forward-looking statements made by or on behalf of the Company as a result of various factors. Any forward-looking statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.

Overview

Since 2004, NowAuto Group, Inc., a Nevada corporation (the "Company") has been a publicly held retailer focused on the "Buy Here/Pay Here" segment of the used vehicle market. The Company generally sells used vehicles less than 10 years old and provides financing for substantially all of its customers. Many of the Company's customers have limited financial resources and would not qualify for conventional financing as a result of limited credit histories or past credit problems. As of December 31, 2010 the Company had two retail locations, all of which are located in the State of Arizona.

The market for used vehicle sales in the United States is significant. Used vehicle retail sales typically occur through franchised new vehicle dealerships that sell used vehicles, or independently owned used vehicle dealerships. The Company operates in the "Buy Here/Pay Here" segment of the independent used vehicle sales and finance market. Buy Here/Pay Here dealers sell and finance used vehicles to individuals with limited credit histories or past credit problems. Buy Here/Pay Here dealers typically offer their customers certain advantages over more traditional financing sources, such as broader and more flexible credit terms, attractive payment terms, including scheduling payments on a weekly or bi-weekly basis to coincide with a customer's payday, and the ability to make payments in person, an important feature to individuals who may not have checking accounts. In turn, interest rates on vehicle loans provided by the Company are generally higher than those offered to individuals who purchase from other new or used vehicle dealers or who have better credit histories.

Our primary focus is on sales and collections. We are responsible for our own collections through our internal collection department, with the supervisory involvement of the corporate office. In the past six months we have implemented new contract terms including lower interest rates and shorter payback periods. While in the short term these measures contributed to lower total sales, we believe that our loan portfolio will result in lower credit losses in the future. In addition, credit losses are impacted, to some degree, by economic conditions in the market in which we operate. In recent years, significant contractions in the local economy, particularly the construction industry, combined with the resulting increase in unemployment have had a negative effect on our market and business. While we believe that the most significant factor affecting credit losses is the proper execution of our business practices, we also believe that current economic conditions have had a negative impact on both sales and collection results.

Hiring, training and retaining qualified personnel are critical to the Company's success. The number of trained managers the Company has at its disposal will limit the rate at which the Company adds new stores. Excessive turnover, particularly at the store manager level, could impact the Company's ability to add new stores. The Company expects to continue to invest in the development of its workforce.

Three and Six Months Ended December 31, 2010 vs. Three and Six Months Ended December 31, 2009

Total revenue for the quarter ended December 31, 2010 was $1,039,676 versus revenue of $1,481,541 for the quarter ended December 31, 2009 and $2,141,365 for the six months ended December 31, 2010 versus $2,908,168 for the previous year. The average sales price per unit increased from approximately $9,338 to $9,645 for the same periods; however, the increase in the unit price was offset by a decrease in unit sales of approximately 7%. The increase to the unit price and the decline in the unit volume were primarily caused by the current economy in the Phoenix area. The supply of vehicles available for purchase has constricted, increasing our cost and resulting in higher sales prices which has negatively affected sales. Sales volume has also been negatively affected by the poor general economic conditions in the greater Phoenix area.

The Company's gross profit as a percentage of sales during the quarter ending December 31, 2010 was 62.9% versus 54.0% for the quarter ended December 31, 2009 and 62.9% for the six months ended December 31, 2010 versus 52.7% for the prior year. The increase in our gross margin was primarily caused by the Company’s ongoing efforts to capture the true costs of our vehicles through an improved tracking process. Further, we have been able to offset the increase in the cost of our vehicles discussed above through corresponding increases to the sales price of the vehicles.

Total operating expenses were 92.7% of total revenues for the quarter ended December 31, 2010 versus 71.9% for the quarter ended December 31, 2009 which includes both selling and financing costs as well as general and administrative expenses. Operating expenses for the six months ended December 31, 2010 was 88% versus 68.4% for the prior year.

Selling and financing costs, which primarily consist of sales and financing salaries and bad debt expense, were 56.5% of total revenues for the quarter ended December 31, 2010 versus 40.7% for the quarter ended December 31, 2009, 53.8% for the six months ended December 31, 2010 versus 38.5% for the prior year. Salary expense for sales and financing staff decreased by 16% in the current quarter when compared to the prior quarter from approximately $179,000 in 2009 to approximately $150,000 in 2010. This was primarily accomplished through the reduced commissions and bonuses as these are directly related to sales. However, the decrease was not at a level commensurate with the decline in revenues. Additionally, bad debt expense has increased in the current quarter by 7% from approximately $355,000 in 2009 to approximately $379,000 in 2010. While the Company believes that proper execution (or lack thereof) of its business practices is the most significant factor affecting credit losses, we also believe that general economic conditions, including but not limited to rising unemployment and troubled credit markets adversely affect collection efforts and have resulted in higher than normal account losses. Also contributing to the increase was the improvement in vehicle cost identification process (discussed above) which has led to more allocation of costs to selling and financing versus cost of sales.

General and administrative expenses, which primarily consist of administrative and executive salaries, rent and other general corporate expenses, have decreased from approximately $461,000 to approximately $376,000. However, this decrease was not at a level commensurate with the decline in sales as G&A expenses were 36.2% of total revenues for the quarter ended December 31, 2010 versus 31.1% for the quarter ended December 31, 2009 and 34.3% for the six months ended December 31, 2010 versus 29.9% for the prior year. The overall decrease in the expense was primarily from decreases in general corporate expenditures due in part to closing a low profit lot. However, these decreases were partially offset by the improvement in vehicle cost identification process (discussed above) which has led to more allocation of costs to general and administrative expenses versus cost of sales.

Liquidity and Capital Resources

The Company’s liabilities exceeded its assets by approximately $9,500,000 and $8,400,000 as of December 31, 2010 and June 30, 2010, respectively. The deterioration in our financial condition was primarily the result of our net loss during the current operating period which resulted in additional draws on our line of credit to fund operations.

Cash and cash equivalents at December 31, 2010 were approximately $56,900 versus approximately $55,000 at June 30, 2010.

Cash used by operating activities was approximately $869,000 for the quarter ended December 31, 2010 which was a $78,000 decrease from cash used by operating activities of approximately $946,600 for the quarter ended December 31, 2009. With the decline in sales the Company has not had significant increases to its Investment in Sales-Type Lease balance to offset the current period collection of prior period sales.

The Company did not have cash used in or provided by investing activities during the quarter ended December 31, 2010. In the quarter ended December 31, 2009 cash used in investing activities was approximately $5,000. The current period decrease was primarily due to a reduction in the purchase of office equipment.

Net cash provided by financing activities during the six months ended December 31, 2010 was approximately $872,000 versus approximately $966,000 for the six months ended December 31, 2009. This activity for both periods is a result of additional draws on the Company's line of credit.

At December 31, 2010, the Company had approximately a $13.8 million line of credit balance under a $14 million line of credit agreement with a privately held, independent finance company. Interest rate on the line of credit agreement is at prime plus 6% (9.25% at December 31, 2010). The line of credit agreement has two covenants (see Note 5 to the accompanying condensed consolidated financial statements), neither of which the Company is in compliance with as of December 31, 2010. However, management believes they have a positive relationship with the independent finance company and does not expect, although no assurance can be made, that any collection activity is imminent as a result of these defaults. The original line of credit with the lender at its inception in 2006 was $3,000,000 and the lender has periodically and consistently increased the limit as the need arose.

Considering the Company's current working capital position management estimates that the current cash position will not be adequate to meet cash requirements for the next twelve months and that additional draws will need to be made against the line of credit to fund operations. Subsequent to December 31, 2010, the Company has been allowed to take additional draws under the revolving credit agreement. We anticipate that we will be able to continue to draw on this credit facility as the need arises until such time as we are able to generate sufficient cash flow from operations to be self sufficient and commence repaying the debt. However, we cannot be certain that this financing will be available.

Although management cannot assure that future operations will be profitable, or that additional debt and/or equity financing will be available, we believe our current cash balance, together with additional debt financing, may provide adequate capital resources to maintain operations for the next year. If additional working capital is required during fiscal 2011 and not obtained through additional debt, equity capital or operations, it could adversely affect future operations. As a result, the Company's independent registered public accountants issued a going concern opinion on the consolidated financial statements of the Company for the year ended June 30, 2010. However, management has historically been successful in obtaining financing and has demonstrated the ability to implement a number of cost-cutting initiatives to reduce working capital needs. Accordingly, the condensed consolidated financial statements contained in Item 1 of this Form 10-Q have been prepared assuming the Company will continue to operate and do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

Critical Accounting Policies

Significant accounting policies are described in the audited consolidated financial statements and notes thereto included in our Report on Form 10-K for the year ended June 30, 2010. We believe our most critical accounting policies and estimates relate to the determination of the allowance for doubtful accounts, the realization of deferred financing revenue, the residual value of leases, and the carrying value of inventory. Due to the uncertainties inherent in the estimation process and the significance of these items, it is at least reasonably possible that the estimates in connection with these items could be materially revised within the next year.

Off-Balance Sheet Arrangements

As of December 31, 2010, we did not have any relationship with unconsolidated entities or financial partnerships, which other companies have been established for the purpose of facilitating off-balance sheet arrangements. Therefore, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

Recent accounting pronouncements are more fully addressed in Note 6 to the accompanying financial statements.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable, as the Company is a smaller reporting company.

Item 4. Controls and Procedures

(a) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Company carried out, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended). Based on their evaluation, the Company's Chief Executive Officer and its Chief Financial Officer concluded that, the Company's disclosure controls and procedures were not effective as of the end of the period covered by this report, because of the material weaknesses identified as of June 30, 2010. Notwithstanding the existence of the material weaknesses identified as of June 30, 2010, management has concluded that the condensed consolidated financial statements in this Form 10-Q fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods and dates presented.

(b) CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal control over financial reporting that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

The Company is continuing the process of developing and implementing a remediation plan to address the material weaknesses as described above, as more fully discussed in the Form 10-K filing for the year ended June 30, 2010.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

As of December 31, 2010 the Company is not involved in any legal proceedings other than standard collection activities deemed to be in the normal course of business.

Item 1a. Risk Factors

No additional significant risk factors have been identified beyond those discussed in the Form 10-K filing for the year ended June 30, 2010.

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

None.

Item 3. Defaults Upon Senior Securities

The Company's revolving credit agreement has two debt covenants. The Company must maintain a tangible net worth of at least $2,000,000 and a leverage ratio that total liabilities cannot exceed four times the tangible net worth. As of December 31, 2010 we are not in compliance with either of these covenants. However we believe that we have a strong relationship with our lender and do not anticipate, without any assurance, that any collection actions are imminent.

Item 4. [Removed and Reserved]

Item 5. Other Information

None.

Item 6. Exhibits

3.1.	Consent of Independent Registered Public Accounting Firm
31.1.	Rule 13a-14(a) certification
31.2.	Rule 13a-14(a) certification
32.1.	Rule Section 1350 certification

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NOW AUTO GROUP, INC.

Date: 2/22/11	By:	/s/ Scott Miller, Scott Miller, Chief Executive Officer

NOW AUTO GROUP, INC.

Date: 2/22/11	By:	/s/ Faith Forbis Faith Forbis Chief Financial Officer, Principle Accounting Officer