

MICROFINANCIAL INC
Form 10-K
March 31, 2014
Table of Contents

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

FORM 10-K

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

For the fiscal year ended December 31, 2013

OR

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

Commission File No. 1-14771

MicroFinancial Incorporated

(Exact name of Registrant as Specified in its Charter)

Massachusetts
(State or other jurisdiction of
incorporation or organization)

04-2962824
(I.R.S. Employer
Identification No.)

16 New England Executive Park, Suite 200,

01803

Burlington, MA
(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: (781) 994-4800

Securities registered pursuant to Section 12(b) of the Act:

Title of each class
Common Shares, \$0.01 par value per share

Name of each exchange on which registered
The Nasdaq Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 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 than the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one).

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark if the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the registrant's voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2013, the last day of the registrant's most recently completed second fiscal quarter, was approximately \$69,742,148 computed by reference to the closing price of such stock as of such date.

As of March 17, 2014, 14,417,185 shares of the registrant's common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement to be filed pursuant to Regulation 14A within 120 days after the Registrant's fiscal year end of December 31, 2013, are incorporated by reference in Part III hereof.

Table of Contents**Table of Contents**

Description	Page Number
PART I	
Item 1. <u>Business</u>	2
Item 1A. <u>Risk Factors</u>	7
Item 2. <u>Properties</u>	12
Item 3. <u>Legal Proceedings</u>	13
Item 4. <u>Mine Safety Disclosures</u>	13
PART II	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	14
Item 6. <u>Selected Financial Data</u>	16
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations, Including Selected Quarterly Financial Data (Unaudited)</u>	19
Item 7A. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	32
Item 8. <u>Financial Statements and Supplementary Data</u>	32
Item 9. <u>Changes In and Disagreements with Accountants on Accounting and Financial Disclosure</u>	32
Item 9A. <u>Controls and Procedures</u>	32
Item 9B. <u>Other Information</u>	33
PART III	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	34
Item 11. <u>Executive Compensation</u>	34
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	34
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	35
Item 14. <u>Principal Accountant Fees and Services</u>	35
PART IV	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	36
<u>SIGNATURES</u>	40

Table of Contents**PART I****ITEM 1. BUSINESS****General**

MicroFinancial Incorporated (referred to as MicroFinancial, we, us or our) was formed as a Massachusetts corporation on January 27, 1987. We operate primarily through our wholly-owned subsidiaries, TimePayment Corp.

(TimePayment) and LeaseComm Corporation (LeaseComm). TimePayment is a specialized commercial/consumer finance company that leases and rents equipment and provides other financing services, with a primary focus on the microticket market. LeaseComm originated leases from January 1986 through October 2002, and continues to service its remaining contract portfolio. TimePayment commenced originating contracts in July 2004. Using proprietary software, we have developed a sophisticated, multi-level pricing model and automated our credit approval and collection systems, including a fully-automated Internet-based application, credit scoring and approval process.

We provide financing alternatives to a wide range of lessees ranging from start-up businesses to established enterprises. We primarily lease and rent low-priced commercial equipment, which is used by these lessees in their daily operations. We do not market our services directly to lessees. We primarily source our originations through a nationwide network of independent equipment vendors, independent sales organizations, brokers and other dealer-based origination networks (to whom we refer collectively in this report as dealers). We fund our operations through cash provided by operating activities and borrowings under our revolving line of credit.

TimePayment finances a wide variety of products, including, but not limited to, water filtration systems, food service equipment, security equipment, point of sale (POS) cash registers, salon equipment, copiers, health care and fitness equipment and automotive repair equipment. Water filtration systems represented approximately 25% of our outstanding lease receivables as of December 31, 2013. No other single product represented more than 10% of our outstanding lease receivables as of December 31, 2013.

We finance the origination of our leases and contracts primarily through cash provided by operating activities and borrowings under our revolving line of credit. We entered into the revolving line of credit in August 2007 with a bank syndicate led by Santander Bank (formerly known as Sovereign Bank) (Santander) based on qualified TimePayment lease receivables. The total commitment under the facility, originally \$30 million, has been increased at various times, most recently in December 2012, from \$100 million to \$150 million. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets.

The following table demonstrates the total commitment under the revolving credit facility with the associated rate options in effect during the three years ended December 31, 2013. As of December 31, 2013, the total commitment under the facility was \$150 million.

Amendment Date	Total Commitment under Credit Facility (in millions)	Rate options⁽¹⁾	Minimum Rate	Facility Expiration
July 2010	\$100	Prime plus 1.25% or LIBOR plus 3.25%	None	August 2013

Edgar Filing: MICROFINANCIAL INC - Form 10-K

October 2011	100	Prime plus 0.75%	or	LIBOR plus 2.75%	None	August 2014
December 2012	150	Base ⁽²⁾ plus 0.75%	or	LIBOR plus 2.50%	None	December 2016

- (1) Under the terms of the facility, loans are Base Rate Loans (or prior to December 2012, Prime Rate Loans), unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity, it automatically converts to a Base Rate Loan.
- (2) The Base Rate is the highest of the prime rate established by the Agent, or one-month LIBOR plus 1%, or the federal funds effective rate plus 0.5%.

-2-

Table of Contents

At December 31, 2013, \$65.0 million of our loans were LIBOR Loans and \$7.6 million of our loans were Base Rate Loans. As of December 31, 2013, the qualified lease receivables eligible under the borrowing base computation were approximately \$129.9 million.

Leasing, Servicing and Financing Programs

We originate leases for products that typically have limited distribution channels and are costly to sell. We facilitate sales of such products by allowing dealers to make them available to their customers for a small monthly lease payment rather than a higher initial purchase price. We primarily lease and rent low-priced commercial equipment to small merchants. In addition, we have acquired service contracts and contracts in certain other financing markets and continue to look for opportunities to invest in these types of assets. Our current portfolio also includes consumer financings which consist of service contracts from dealers that primarily provide residential security monitoring services, as well as consumer leases for a wide range of consumer products.

We originate and continue to service contracts in all 50 states, the District of Columbia and Puerto Rico. The concentration of leases in certain states as of the end of each of the past three years, as a percentage of our total portfolio, is reflected below. No other state accounted for more than five percent of such total.

Year Ended				
December 31,	Florida	California	Texas	New York
2011	13%	11%	8%	9%
2012	13%	12%	8%	8%
2013	13%	12%	9%	8%

Terms of Equipment Leases

Substantially all equipment leases originated or acquired by us are non-cancelable. We generally originate leases on transactions referred to us by a dealer where we buy the underlying equipment from the referring dealer upon funding the approved application. Leases are structured with limited recourse to the dealer, with risk of loss in the event of default by the lessee residing with us in most cases. We perform all the processing, billing and collection functions under our leases.

During the term of a typical lease, we receive payments sufficient, in the aggregate, to cover our borrowing cost and the cost of the underlying equipment, and to provide us with an appropriate profit. Throughout the term of the lease, we charge late fees, prepayment penalties, loss and damage waiver fees and other service fees, when applicable. Initial terms of the leases we funded in 2013 generally range from 12 to 60 months, with an average initial term of 41 months.

The terms and conditions of all of our contracts are substantially similar. In most cases, the contracts require lessees to: (i) maintain, service and operate the equipment in accordance with the manufacturer's and government-mandated procedures; (ii) insure the equipment against property and casualty loss; (iii) pay all taxes associated with the equipment; and (iv) make all scheduled contract payments regardless of the performance of the equipment. Our standard lease forms provide that in the event of a default by the lessee, we can require payment of liquidated damages and can seize and remove the equipment for sale, refinancing or other disposal at our discretion. Any additions, modifications or upgrades to the equipment, regardless of the source of payment, are automatically incorporated into, and deemed a part of, the equipment financed.

We seek to protect ourselves from credit exposure relating to dealers by entering into limited recourse agreements with our dealers, under which the dealer agrees to reimburse us for defaulted contracts under certain circumstances, primarily upon evidence of dealer errors or misrepresentations in originating a lease or contract.

Table of Contents

Residual Interests in Underlying Equipment

We typically own a residual interest in the equipment covered by our leases. The value of such interest is estimated at inception of the lease based upon our estimate of the fair market value of the asset at lease maturity. At the end of the lease term, the lessee has the option to buy the equipment at the fair market value, return the equipment or continue to rent the equipment on a month-to-month basis.

Dealers

We provide financing to obligors under leases and contracts through a nationwide network of dealers, including equipment vendors, independent sales organizations and brokers. We do not sign exclusive agreements with our dealers. Dealers interact directly with potential lessees and typically market not only their products and services, but also the financing arrangements offered through us. During 2013, we had over 1,150 different dealers originating leases and contracts.

During the years ended December 31, 2013, 2012 and 2011, our top dealer accounted for 13.8%, 4.4% and 3.3%, respectively, of the value of leases originated. The top dealer during this three-year period was a lease broker who represents a number of equipment vendors financing a wide breadth of different equipment segments and operates on a nationwide scope.

Use of Technology

Our business is operationally intensive, due in part to the small average amount financed. Accordingly, technology and automated processes are critical in keeping servicing costs to a minimum while providing quality customer service.

We have developed TimePaymentDirect, an Internet-based application processing, credit approval and dealer information tool. Using TimePaymentDirect, a dealer can input an application and obtain an almost instantaneous credit decision automatically over the Internet, all without any contact with our employees. We also offer Instalease[®], a program that allows a dealer to submit applications to us by telephone, telecopy or e-mail, receive approval, and complete a sale from a lessee's location. By assisting the dealers in providing timely, convenient and competitive financing for their equipment contracts and offering dealers a variety of value-added services, we simultaneously promote equipment contract sales and the utilization of TimePayment as the preferred finance provider, thus differentiating us from our competitors.

We have used our proprietary software to develop a multidimensional credit-scoring model which generates pricing of our leases and contracts commensurate with the risk assumed. This software does not produce a binary yes or no decision, but rather, for a yes decision, determines the price at which the lease or contract might be profitably underwritten. We use this credit scoring model in most, but not all, of our credit decisions.

Underwriting

The nature of our business requires that the underwriting process perform two levels of review: the first focused on the ultimate end-user of the equipment or service and the second focused on the dealer. The approval process begins with the submission by telephone, facsimile or electronic transmission of a credit application by the dealer. Upon submission, we either manually or through TimePaymentDirect conduct our own independent credit investigation of the lessee using our proprietary database. In order to facilitate this process, we will use recognized commercial credit reporting agencies such as Dun & Bradstreet, Paynet and Experian. Our software evaluates this information on a

two-dimensional scale, examining both credit depth (how much information exists on an applicant) and credit quality (credit performance, including past payment history). We use this information to underwrite a broad range of credit risks and provide financing in situations where our competitors may be unwilling to provide such financing. The credit-scoring model is complex and automatically adjusts for different transactions. In situations where the amount financed is over \$10,000, we may go beyond our own

Table of Contents

database and recognized commercial credit reporting agencies to obtain information from less readily available sources such as banks. In certain instances, we will require the lessee to provide verification of employment and salary.

The second aspect of the credit decision involves an assessment of the originating dealer. Dealers undergo both an initial screening process and ongoing evaluation, including an examination of dealer portfolio credit quality and performance, lessee complaints, cases of fraud or misrepresentation, aging studies, application activity and conversion rates for applications. This ongoing assessment enables us to manage our dealer relationships, and in some instances, may result in ending our relationships with poorly performing dealers.

Upon credit approval, we require receipt of a signed lease on our standard or other pre-approved lease form. After the equipment is shipped and installed, the dealer invoices us and we verify that the lessee has received and accepted the equipment. Upon the completion of a satisfactory verification with the lessee, the lease is forwarded to our funding and documentation department for payment to the dealer and the establishment of the accounting and billing procedures for the transaction.

Service Contracts

We also acquire service contracts under which a homeowner purchases a security system and simultaneously signs a contract with the dealer for the monitoring of that system for a monthly fee. Upon approval of the monitoring application and verification with the homeowner that the system is installed, we purchase the right to the payment stream under the monitoring service contract from the dealer at a negotiated multiple of the monthly payments. In years prior to 2012, our service contract revenue was derived from our LeaseComm portfolio, for which we have not purchased any new security service contracts since 2002. Consequently, our service contract revenue from LeaseComm represents a less significant portion of our revenue stream over time. Beginning in the second quarter of 2012, TimePayment began purchasing service contracts.

Bulk and Portfolio Acquisitions

In addition to originating leases through our dealer relationships, from time to time we have also purchased lease portfolios from dealers or other sources. While certain of these leases may not have met our underwriting standards at inception, we will purchase the leases once the lessee demonstrates a satisfactory payment history. We prefer to acquire these smaller lease portfolios in situations where the seller will continue to act as a dealer following the acquisition. We did not purchase any material portfolios in the three most recent fiscal years.

Servicing and Collections

We perform all the servicing functions on our leases and contracts through our automated servicing and collection system. Servicing responsibilities generally include billing, processing payments, remitting payments to dealers, paying taxes and insurance and performing collection and liquidation functions.

Our automated lease administration system handles application tracking, invoicing, payment processing, automated collection queuing, portfolio evaluation and report writing. The system is linked with our bank accounts for payment processing and also provides for direct withdrawal of lease and contract payments from a lessee's bank account. We monitor delinquent accounts using our automated collection process. We use several computerized processes in our customer service and collection efforts, including the generation of daily priority call lists and scrolling for daily delinquent account servicing, generation and mailing of delinquency letters, and routing of incoming customer service calls to appropriate employees with instant computerized access to account details. Our collection efforts include

sending collection letters, making collection calls, reporting delinquent accounts to credit reporting agencies, and litigating delinquent accounts when necessary to obtain and enforce judgments.

Table of Contents**Competition**

The microticket leasing and financing industry is highly competitive. We compete for customers with a number of national, regional and local banks and finance companies. Our competitors also include equipment manufacturers that lease or finance the sale of their own products. While the market for microticket financing has traditionally been fragmented, we could also be faced with competition from small or large-ticket leasing companies that could use their expertise in those markets to enter and compete in the microticket financing market. Our competitors include larger, more established companies, some of which may possess substantially greater financial, marketing and operational resources than us, including a lower cost of funds and access to capital markets and other funding sources which may be unavailable to us.

Employees

As of December 31, 2013, we had 155 full-time employees, of whom 60 were engaged in sales and underwriting activities and dealer service, 65 were engaged in servicing and collection activities, and 30 were engaged in general administrative activities. We believe that our relationship with our employees is good. None of our employees are members of a collective bargaining unit in connection with their employment with us.

Executive Officers

Name and Age of Executive Officers	Title
Richard F. Latour, 60	Director, President, Chief Executive Officer, Treasurer, Clerk and Secretary
James R. Jackson, Jr., 52	Senior Vice President and Chief Financial Officer
Steven J. LaCreta, 54	Vice President, Lessee Relations and Legal
Stephen J. Constantino, 48	Vice President, Human Resources
Vartan Hagopian, 56	Vice President, Sales (TimePayment Corp.)

Richard F. Latour has served as our President, Chief Executive Officer, Treasurer, Clerk and Secretary since October 2002. Prior to becoming Chief Executive Officer, he served as President, Chief Operating Officer, Treasurer, Clerk and Secretary from February 2002, since which time he has also been a director. From 1995 to January 2002, he served as Executive Vice President, Chief Operating Officer, Chief Financial Officer, Treasurer, Clerk and Secretary. From 1986 to 1995 Mr. Latour served as Vice President of Finance and Chief Financial Officer. Prior to joining us, Mr. Latour was Vice President of Finance with Trak Incorporated, an international manufacturer and distributor of consumer goods, where he was responsible for all financial and operational functions. Mr. Latour earned a B.S. in accounting from Bentley College in Waltham, Massachusetts.

James R. Jackson Jr. served as our Vice President and Chief Financial Officer from April 2002 until February 2014, when he was promoted to Senior Vice President and Chief Financial Officer. Prior to joining us, from 1999 to 2001, Mr. Jackson was Vice President of Finance for Deutsche Financial Services Technology Leasing Group. From 1992 to 1999, Mr. Jackson held positions as Manager of Pricing and Structured Finance and Manager of Business Planning with AT&T Capital Corporation.

Steven J. LaCreta has served as our Vice President, Lessee Relations and Legal since May 2005. From May 2000 to May 2005, Mr. LaCreta served as Vice President, Lessee Relations. From November 1996 to May 2000, Mr. LaCreta served as our Director of Lessee Relations. Prior to joining us, Mr. LaCreta was a Leasing Collection Manager with Bayer Corporation.

Edgar Filing: MICROFINANCIAL INC - Form 10-K

Stephen J. Constantino has served as our Vice President, Human Resources since May 2000. From 1994 to May 2000, Mr. Constantino served as our Director of Human Resources. From 1992 to 1994, Mr. Constantino served as our Controller. From 1991 to 1992, Mr. Constantino served as our Accounting Manager.

Vartan Hagopian was appointed Vice President of Sales of our primary subsidiary, TimePayment Corp., in December 2011. Prior to joining us, from 1998 to 2007, Mr. Hagopian served in senior sales leadership roles at

Table of Contents

Monster Worldwide, Inc. After Monster, Mr. Hagopian served in senior sales leadership roles at Yodle, Inc. from 2007 to 2008 and Health Diagnostics, LLC from 2008 to 2009. He established a sales strategy consulting practice for startup companies from 2009 to 2011.

Availability of Information

We maintain an Internet website at <http://www.microfinancial.com>. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as well as Section 16 reports on Form 3, 4, or 5, are available free of charge on this site as soon as is reasonably practicable after they are filed or furnished with the Securities and Exchange Commission (SEC). Our Guidelines on Corporate Governance, our Code of Business Conduct and Ethics and the charters for the Audit Committee, Nominating and Corporate Governance Committee, Compensation and Benefits Committee, Credit Policy Committee and Strategic Planning Committee of our Board of Directors are also available on our Internet site. The Guidelines, Code of Ethics and charters are also available in print to any shareholder upon request. Requests for such documents should be directed to Richard F. Latour, Chief Executive Officer, at 16 New England Executive Park Suite 200, Burlington, MA 01803. Our Internet site and the information contained therein or connected thereto are not incorporated by reference into this Form 10-K. Our filings with the SEC are also available on the SEC's website at <http://www.sec.gov>.

ITEM 1A. RISK FACTORS

Set forth below and elsewhere in this report and in other documents we file with the Securities and Exchange Commission are risks and uncertainties that could cause our actual results to differ materially from the results contemplated by the forward-looking statements contained in this report and other periodic statements we make.

We depend on external financing to fund leases and contracts, and adequate financing may not be available to us in amounts that are sufficient, together with our cash flow, to originate new leases.

Our lease and finance business is capital intensive and requires access to substantial short-term and long-term credit to fund leases and contracts. We will continue to require significant additional capital to maintain and expand our funding of leases and contracts, as well as to fund any future acquisitions of leasing companies or portfolios. Our uses of cash include the origination and acquisition of leases and contracts, payment of interest and principal on borrowings, payment of selling, general and administrative expenses, income taxes, capital expenditures and dividends.

Since August 2007, we have had a revolving line of credit with a bank syndicate led by Santander based on qualified TimePayment lease receivables. The total commitment under the facility is currently \$150 million and the maturity date is December 2016. At December 31, 2013, \$72.6 million was outstanding under the facility. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets.

Our ability to draw down amounts under our credit facility is potentially restricted by a borrowing base calculated with respect to our eligible receivables (\$129.9 million at December 31, 2013), and our revolving line of credit has financial covenants that we must comply with to obtain funding and avoid an event of default. Our credit facility contains certain provisions which limit our ability to incur indebtedness from other sources. Any credit facility we enter into upon renewal or replacement of our existing credit facility may have similar or additional financial covenants or restrictions. Any default or other interruption of our external funding could have a material negative effect on our ability to fund new leases and contracts, and could, as a consequence, have an adverse effect on our

financial results.

-7-

Table of Contents

A protracted economic downturn may cause an increase in defaults under our leases and lower demand for the commercial equipment we lease.

A protracted economic downturn, similar to the one the United States and other nations experienced in recent years, could result in a decline in the demand for some of the types of equipment or services we finance, which could lead to a decline in originations. A protracted economic downturn may slow the development and continued operation of small commercial businesses, which are the primary market for the commercial equipment leased by us. Such a downturn could also adversely affect our ability to obtain capital to fund lease and contract originations or acquisitions, or to complete securitizations. In addition, a protracted downturn could result in an increase in delinquencies and defaults by our lessees and other obligors, which could have an adverse effect on our cash flow and earnings, as well as on our ability to securitize leases. These factors could have a material adverse effect on our business, financial condition and results of operations.

Additionally, as of December 31, 2013, leases in the states of Florida, California, Texas and New York collectively accounted for approximately 42% of our portfolio. Economic conditions in these states may affect the level of collections from, as well as delinquencies and defaults by, these obligors and may thus have a disproportionate effect on our operations compared to economic conditions in other states or regions.

We experience a significant rate of default under our leases, and a higher than expected default rate would have an adverse effect on our cash flow and earnings.

Even in times of general economic growth, the credit characteristics of our lessee base correspond to a high incidence of delinquencies, which in turn may lead to significant levels of defaults. The credit profile of our lessees heightens the importance of both pricing our leases and contracts for the risk assumed, as well as maintaining an adequate allowance for losses. Our lessees, moreover, have been affected by the recent economic downturn, like many small businesses. Significant defaults by lessees in excess of those we anticipate in setting our prices and allowance levels may adversely affect our cash flow and earnings. Reduced cash flow and earnings could limit our ability to repay debt and obtain financing, which could have a material adverse effect on our business, financial condition and results of operations.

In addition to our usual practice of originating leases through our dealer relationships, from time to time we have purchased lease portfolios from dealers. While certain of these leases at inception would not have met our underwriting standards, we will purchase leases once the lessee demonstrates a payment history. We prefer to acquire these smaller lease portfolios in situations where the company selling the portfolio will continue to act as a dealer following the acquisition. Despite the demonstrated payment history, such leases may experience a higher rate of default than leases that meet our origination standards.

Our allowance for credit losses may prove to be inadequate to cover future credit losses.

We maintain an allowance for credit losses on our investments in leases, service contracts and rental contracts at an amount we believe is sufficient to provide adequate protection against losses in our portfolio. We cannot be sure that our allowance for credit losses will be adequate over time to cover losses caused by adverse economic factors, or unfavorable events affecting specific leases, industries or geographic areas. Losses in excess of our allowance for credit losses may have a material adverse effect on our business, financial condition and results of operations.

We are vulnerable to changes in the demand for the types of equipment we lease or price reductions in such equipment.

Our portfolio is comprised of a wide variety of equipment including, but not limited to, water filtration systems, food service equipment, security equipment, point of sale (POS) cash registers, salon equipment, copiers, health care and fitness equipment and automotive repair equipment. As of December 31, 2013, water filtration systems represented approximately 25% of the amount financed by TimePayment. Reduced demand for

Table of Contents

financing of the types of equipment we lease could adversely affect our lease origination volume, which in turn could have a material adverse effect on our business, financial condition and results of operations. Technological advances may lead to a decrease in the price of these types of systems or equipment and a consequent decline in the need for financing of such equipment. These changes could reduce the need for outside financing sources that would reduce our lease financing opportunities and origination volume in such products. These types of equipment are often leased by small commercial businesses which may be particularly susceptible to economic downturn, which may also affect demand for these products.

In the event that demand for financing the types of equipment that we lease declines, we will need to expand our efforts to provide lease financing for other products. There can be no assurance, however, that we will be able to do so successfully. Because many dealers specialize in particular products, we may not be able to capitalize on our current dealer relationships in the event we shift our business focus to originating leases of other products. Our failure to successfully enter into new relationships with dealers of other products or to extend existing relationships with such dealers in the event of reduced demand for financing of the systems and equipment we currently lease would have a material adverse effect on us.

We may face adverse consequences of litigation, including consequences of using litigation as part of our collection policy.

Our use of litigation as a means of collection of unpaid receivables exposes us to counterclaims on our suits for collection, to class action lawsuits and to negative publicity surrounding our leasing and collection policies. We have been a defendant in attempted class action suits as well as counterclaims filed by individual obligors in attempts to dispute the enforceability of the lease or contract. This type of litigation may be time consuming and expensive to defend, even if not meritorious, may result in the diversion of management's time and attention, and may subject us to significant liability for damages or result in invalidation of our proprietary rights. We believe our collection policies and use of litigation comply fully with all applicable laws. Because of our persistent enforcement of our leases and contracts through the use of litigation, we may have created ill will toward us on the part of certain lessees and other obligors who were defendants in such lawsuits. Our litigation strategy has also generated adverse publicity in certain circumstances. Adverse publicity could negatively impact public perception of our business and may materially impact the price of our common stock. In addition to legal proceedings that may arise out of our collection activities, we may face other litigation arising in the ordinary course of business. Any of these factors could adversely affect our business, financial condition and results of operations.

Increased interest rates may make our leases or contracts less profitable.

Since we generally fund our leases and contracts through our credit facilities or from working capital, our operating margins could be adversely affected by an increase in interest rates. As of December 31, 2013, the applicable interest rate for borrowings under our credit facility is, at our option, the base rate plus 0.75% per annum or LIBOR plus 2.50%. The base rate is the highest of the prime rate established by the Agent, or one-month LIBOR plus 1%, or the federal funds effective rate plus 0.5%. The implicit yield on all of our leases and contracts is fixed due to the leases and contracts having scheduled payments that are fixed at the time of origination. When we originate or acquire leases or contracts, we base our pricing in part on the spread we expect to achieve between the implicit yield on each lease or contract and the effective interest cost we expect to pay when we finance such leases and contracts. Increases in interest rates during the term of each lease or contract could narrow or eliminate the spread or result in a negative spread to the extent such lease or contract was financed with variable-rate funding. We may undertake to hedge against the risk of interest rate increases, based on the size and interest rate profile of our portfolio. Such hedging activities, however, would limit our ability to participate in the benefits of lower interest rates with respect to the hedged portfolio. In addition, our hedging activities may not protect us from interest rate-related risks in all interest

rate environments. Adverse developments resulting from changes in interest rates or hedging transactions could have a material adverse effect on our business, financial condition and results of operations. We do not currently have any hedging arrangements with respect to interest rate changes.

Table of Contents

We may not be able to realize our entire investment in the residual interests in the equipment covered by our leases.

At the inception of a lease, we record a residual value for the lease equipment as an asset based upon an estimate of the fair market value of the equipment at lease maturity. There can be no assurance that our estimated residual values will be realized due to technological or economic obsolescence, unusual wear or tear on the equipment, or other factors. Failures to realize the recorded residual values may have a material adverse effect on our business, financial condition and results of operations.

We face intense competition, which could cause us to lower our lease rates, hurt our origination volume and strategic position and adversely affect our financial results.

The microticket leasing and financing industry is highly competitive. We compete for customers with a number of national, regional and local banks and finance companies. Our competitors also include equipment manufacturers that lease or finance the sale of their own products. While the market for microticket financing has traditionally been fragmented, we could also be faced with competition from small or large-ticket leasing companies that could use their expertise in those markets to enter and compete in the microticket financing market. Our competitors include larger, more established companies, some of which may possess substantially greater financial, marketing and operational resources than us, including lower cost of funds and access to capital markets and other funding sources which may be unavailable to us. If a competitor were to lower its lease rates, we could be forced to follow suit or be unable to regain origination volume, either of which would have a material adverse effect on our business, financial condition and results of operations. In addition, competitors may seek to replicate the automated processes used by us to monitor dealer performance, evaluate lessee credit information, appropriately apply risk-adjusted pricing, and efficiently service a nationwide portfolio. The development of computer software similar to that developed by us may jeopardize our strategic position and allow our competitors to operate more efficiently than we do.

Recently proposed accounting changes may negatively impact the demand for equipment leases.

On August 17, 2010, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) released a joint exposure draft that would dramatically change lease accounting for both lessees and lessors by requiring balance sheet recognition of all leases. At their June 13, 2012, joint board meeting, the International Accounting Standards Board (IASB) and the FASB (collectively, the Boards) agreed on an approach for the accounting for lease expenses as part of their joint project to revise lease accounting. In September 2012, the Boards reached tentative decisions regarding sale and leaseback transactions and other lease accounting issues. The Boards published their revised joint proposals on leases in May 2013, consisting of the revised proposed FASB Accounting Standards Update, Leases (Topic 842) and the IASB's Exposure Draft, Leases. Following several public roundtable meetings on the revised joint proposals, the Boards plan to consider all feedback and begin re-deliberations of all significant issues during 2014. If these accounting changes are adopted in a form that makes equipment leasing less attractive to small business owners, it could result in a reduction in the demand for equipment leases, and could have an adverse effect on our results of operations and financial condition.

Government regulation could restrict our business.

Our leasing business is not currently subject to extensive federal or state regulation. While we are not aware of any proposed legislation, the enactment of, or a change in the interpretation of, certain federal or state laws affecting our ability to price, originate or collect on receivables (such as the application of usury laws to our leases and contracts) could negatively affect the collection of income on our leases and contracts, as well as the collection of fee income. Any such legislation or change in interpretation, particularly in Massachusetts, whose laws govern the majority of our leases and contracts, could have a material adverse effect on our ability to originate leases and contracts at current

levels of profitability, which in turn could have a material adverse effect

Table of Contents

on our business, financial condition or results of operations. Changes to the bankruptcy laws that would make it easier for lessees to file for bankruptcy could increase delinquency and defaults on the existing portfolio.

We may face risks in acquiring other portfolios and companies, including risks relating to how we finance any such acquisition or how we are able to assimilate any portfolios or operations we acquire.

In addition to organic growth a portion of our growth strategy may involve acquisitions of leasing companies or portfolios from time to time. Our inability to identify suitable acquisition candidates or portfolios, or to complete acquisitions on favorable terms, could limit our ability to grow our business. Any major acquisition would require a significant portion of our resources. The timing, size and success, if at all, of our acquisition efforts and any associated capital commitments cannot be readily predicted. We may finance future acquisitions by using shares of our common stock, cash or a combination of the two. Any acquisition we make using common stock would result in dilution to existing stockholders. If the common stock does not maintain a sufficient market value, or if potential acquisition candidates are otherwise unwilling to accept common stock as part or all of the consideration for the sale of their businesses, we may be required to utilize more of our cash resources, if available, or to incur additional indebtedness in order to initiate and complete acquisitions. Additional debt, or intangible assets incurred as a result of any such acquisition, could have a material adverse effect on our business, financial condition or results of operations. In addition, our credit facilities contain covenants that place significant restrictions on our ability to acquire all or substantially all of the assets or securities of another company. These provisions could prevent us from making an acquisition we may otherwise see as attractive, whether by using shares of our common stock as consideration or by using cash.

We also may experience difficulties in the assimilation of the operations, services, products and personnel of acquired companies, an inability to sustain or improve the historical revenue levels of acquired companies, the diversion of management's attention from ongoing business operations, and the potential loss of key employees of such acquired companies. Any of the foregoing could have a material adverse effect on our business, financial condition or results of operations.

If we were to lose key personnel, our operating results may suffer or it may cause a default under our debt facilities.

Our success depends to a large extent upon the abilities and continued efforts of Richard Latour, President and Chief Executive Officer and James R. Jackson, Jr., Senior Vice President and Chief Financial Officer, and our other senior management. We have entered into employment agreements with Mr. Latour and Mr. Jackson, as well as other members of our senior management. The loss of the services of one or more of the key members of our senior management before we are able to attract and retain qualified replacement personnel could have a material adverse effect on our financial condition and results of operations. In addition, under our Santander credit facility, an event of default would arise if Mr. Latour or Mr. Jackson were to leave their positions as our Chief Executive Officer or Chief Financial Officer, respectively, unless replacements suitable to the majority of the lenders under the credit facility were appointed within 90 days. Our failure to comply with these provisions could have a material adverse effect on our business, financial condition or results of operations.

Certain provisions of our articles and bylaws may have the effect of discouraging a change in control or acquisition of the company.

Our restated articles of organization and restated bylaws contain certain provisions that may have the effect of discouraging, delaying or preventing a change in control or unsolicited acquisition proposals that a stockholder might consider favorable, including: (i) provisions authorizing the issuance of blank check preferred stock; (ii) providing for a Board of Directors with staggered terms; (iii) requiring super-majority or class voting to effect certain amendments

to the articles and bylaws and to approve certain business combinations; (iv) limiting the persons who may call special stockholders meetings and; (v) establishing advance notice requirements for nominations for election to the Board of Directors or for proposing matters that can be acted upon at

Table of Contents

stockholders meetings. In addition, certain provisions of Massachusetts law to which we are subject may have the effect of discouraging, delaying or preventing a change in control or an unsolicited acquisition proposal.

Our stock price may be volatile, which could limit our access to the equity markets and could cause you to incur losses on your investment.

If our revenues do not grow or grow more slowly than we anticipate, or if operating expenditures exceed our expectations or cannot be adjusted accordingly, the market price of our common stock could be materially and adversely affected. In addition, the market price of our common stock has been in the past, and could be in the future, materially and adversely affected for reasons unrelated to our specific business or results of operations. General market price declines or volatility in the future could adversely affect the price of our common stock. In addition, short-term trading strategies of certain investors can also have a significant effect on the price of specific securities. In addition, the trading price of the common stock may be influenced by a number of factors, including the liquidity of the market for the common stock, investor perceptions of us and the equipment financing industry in general, variations in our quarterly operating results, interest rate fluctuations and general economic and other conditions. Also, the volatility of the stock market could adversely affect the market price of our common stock and our ability to raise funds in the public markets.

There is no assurance that we will continue to pay dividends on our common stock in the future.

We declared dividends of \$0.25, \$0.24 and \$0.21 per share during 2013, 2012 and 2011, respectively. Future dividend payments are subject to ongoing review and evaluation by our Board of Directors. The decision as to the amount and timing of future dividends we may pay, if any, will be made in light of our financial condition, capital requirements and growth plans, as well as our external financing arrangements and any other factors our Board of Directors may deem relevant. We can give no assurance as to the amount and timing of the payment of future dividends.

Our business operations could be disrupted if our information technology systems fail to perform adequately.

Given the number of transactions we process each year, our business is heavily dependent on our information technology systems. We rely on our information systems to effectively manage our business data, perform underwriting functions, perform billing cycles, process cash collections, perform tax compliance functions, and other vital business processes. Our business system stores the confidential information of our customers, suppliers and employees, including personal identification information, credit card data, and other information. We have taken steps to secure our management information systems.

Our information technology systems may be vulnerable to cyber-attacks or viruses, security breaches, theft of information, interruptions or other damages from circumstances beyond our control including natural disasters and errors from our employees. Cyber-attacks could result in the loss or misuse of information, damage to our reputation, litigation, fines and other potential liabilities. If we encounter damage to our systems, a security breach of our systems or difficulty maintaining or upgrading current systems, our business operations could be disrupted and it could have a material adverse effect on our business.

ITEM 2. PROPERTIES

At December 31, 2013, our corporate headquarters and operations center occupied approximately 24,000 square feet of office space at New England Executive Park in Burlington, Massachusetts 01803. The lease for this space expires on July 31, 2017. In addition, at December 31, 2013, we occupied 4,986 square feet of office space at 2801 Townsgate

Road, Thousand Oaks, CA 91361. The lease for this space expires on June 30, 2018.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS

We are involved from time to time in litigation incidental to the conduct of our business. Although we do not expect that the outcome of any of these matters, individually or collectively, will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered, that could adversely affect our operating results or cash flows in a particular period. We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we assess the likelihood of loss as probable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

Table of Contents**PART II****ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Market Information**

Our common stock, par value \$0.01 per share is currently listed on the Nasdaq Global Market under the symbol MFI. The following chart shows the high and low sales price of our common stock in each quarter over the past two fiscal years.

	2013				2012			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Stock Price								
High	\$ 8.80	\$ 8.58	\$ 9.30	\$ 9.05	\$ 7.11	\$ 8.46	\$ 9.96	\$ 9.48
Low	\$ 6.66	\$ 6.77	\$ 7.47	\$ 7.77	\$ 5.66	\$ 6.19	\$ 7.86	\$ 6.51

Holders

We believe there were approximately 800 stockholders of MicroFinancial, Inc. as of March 15, 2014, including beneficial owners who hold through a broker or other nominee. As of the same date, there were 40 stockholders of record.

Dividends

Dividends declared and paid or payable in the two most recently completed fiscal years were as follows:

2013			Dividend per Share
Date Declared	Record Date	Payment Date	
January 29, 2013	February 8, 2013	February 15, 2013	\$ 0.06
April 23, 2013	May 3, 2013	May 15, 2013	0.06
July 17, 2013	July 30, 2013	August 15, 2013	0.06
October 24, 2013	November 4, 2013	November 15, 2013	0.07
Total			\$ 0.25

2012			
Date Declared	Record Date	Payment Date	Dividend per Share

			Share
January 31, 2012	February 10, 2012	February 15, 2012	\$ 0.06
April 19, 2012	April 30, 2012	May 15, 2012	0.06
July 19, 2012	July 30, 2012	August 15, 2012	0.06
October 18, 2012	October 31, 2012	November 15, 2012	0.06
Total			\$ 0.24

Future dividend payments are subject to ongoing review and evaluation by our Board of Directors. The decision as to the amount and timing of future dividends, if any, will be made in light of our financial condition, capital requirements and growth plans, as well as our external financing arrangements and any other factors our Board of Directors may deem relevant. We can give no assurance as to the amount and timing of future dividends.

Our credit facility also restricts the amount of cash that TimePayment can dividend up to MicroFinancial during any year to 50% of consolidated net income for the immediately preceding year.

Table of Contents

Repurchases

On August 10, 2010, our Board of Directors approved a common stock repurchase program under which we were authorized to purchase up to 250,000 of our outstanding shares from time to time. The repurchases were allowed to take place in either the open market or through block trades. The repurchase program was funded by our working capital and could be suspended or discontinued at any time.

During 2013, we repurchased a total of 97,153 shares of our common stock at an average price per share of \$7.28. The total cost of the shares repurchased was approximately \$708,000. No repurchases were made during the fourth quarter of fiscal 2013. From January 1, 2014 through March 3, 2014, we repurchased an additional 66,552 shares of our common stock at an average price per share of \$8.07. The total cost of the shares repurchased during this period was approximately \$537,000.

Since the program's inception, we have repurchased a total of 250,000 shares of our common stock (which represents the total authorized under this program) at a total cost of approximately \$1.6 million.

Performance Graph

The following graph compares our cumulative total stockholder return since December 31, 2008, with the S&P 400 Mid-Cap Financials Index, the S&P Small Cap 600 Financials Index and the NASDAQ Composite. Cumulative total stockholder return shown in the performance graph is measured assuming an initial investment of \$100 on December 31, 2008, and the reinvestment of dividends. The historic stock price performance information shown in this graph may not be indicative of current stock price levels or future stock price performance.

Table of Contents

The information under the caption Performance Graph above is not deemed to be filed as part of this Annual Report, and is not subject to the liability provisions of Section 18 of the Securities Exchange Act of 1934. Such information will not be deemed to be incorporated by reference into any filing we make under the Securities Act of 1933 unless we explicitly incorporate it into such a filing at the time.

ITEM 6. SELECTED FINANCIAL DATA

The following tables set forth selected consolidated financial and operating data for the periods and at the dates indicated. The selected consolidated financial data were derived from our financial statements and accounting records. The data presented below should be read in conjunction with the consolidated financial statements, related notes and other financial information included herein.

	Year Ended December 31,				
	2013	2012	2011	2010	2009
Income Statement Data:	<i>(Amounts in thousands, except share and per share data)</i>				
Revenues:					
Income on financing leases	\$ 41,153	\$ 40,008	\$ 37,032	\$ 34,398	\$ 29,415
Rental income	10,534	9,737	8,574	7,773	8,584
Income on service contracts	936	388	398	512	676
Other income ⁽¹⁾	9,895	9,183	8,669	8,246	7,490
Total revenues	62,518	59,316	54,673	50,929	46,165
Expenses:					
Selling, general and administrative	18,514	17,466	15,873	13,839	13,371
Provision for credit losses	19,530	19,490	18,250	23,148	22,039
Depreciation and amortization	5,448	4,355	3,270	2,212	1,628
Interest	2,703	2,639	2,661	3,150	2,769
Total expenses	46,195	43,950	40,054	42,349	39,807
Income before provision for income taxes	16,323	15,366	14,619	8,580	6,358
Provision for income taxes	6,560	6,015	5,628	3,284	2,231
Net income	\$ 9,763	\$ 9,351	\$ 8,991	\$ 5,296	\$ 4,127
Net income per common share:					
Basic	\$ 0.68	\$ 0.65	\$ 0.63	\$ 0.37	\$ 0.29
Diluted	0.66	0.64	0.62	0.37	0.29
Weighted-average shares:					
Basic	14,460,613	14,321,815	14,247,413	14,240,308	14,147,436

Edgar Filing: MICROFINANCIAL INC - Form 10-K

Diluted	14,774,529	14,689,531	14,525,566	14,466,266	14,261,644
Dividends declared per common share	\$ 0.25	\$ 0.24	\$ 0.21	\$ 0.20	\$ 0.15

-16-

Table of Contents

	2013	2012	December 31, 2011	2010	2009
	<i>(Dollars in thousands)</i>				
Balance Sheet Data:					
Cash and cash equivalents	\$ 2,246	\$ 3,557	\$ 2,452	\$ 1,528	\$ 391
Restricted cash	1,107	1,213	382	753	834
Gross investment in leases ⁽²⁾	237,698	237,642	223,786	212,899	194,629
Unearned income	(58,772)	(62,244)	(59,946)	(59,245)	(55,821)
Allowance for credit losses	(15,379)	(14,038)	(13,180)	(13,132)	(13,856)
Investment in service contracts, net	2,058	797			
Investment in rental contracts, net	1,059	1,037	898	461	379
Total assets	173,052	169,629	155,342	143,605	127,097
Revolving line of credit	72,566	70,380	62,740	62,650	51,906
Total liabilities	84,572	87,237	79,619	74,118	60,332
Total stockholders equity	88,480	82,392	75,723	69,487	66,765

	2013	2012	December 31, 2011	2010	2009
	<i>(Dollars in thousands, except statistical data)</i>				
Other Data:					
Operating Data:					
Value of leases originated ⁽³⁾	\$ 126,216	\$ 131,375	\$ 114,435	\$ 116,052	\$ 113,987
Investment in lease and service contracts ⁽⁴⁾	89,710	90,777	77,684	77,794	76,306
Average yield on leases ⁽⁵⁾	27.3%	27.6%	27.4%	27.8%	27.7%
Cash Flows From (Used In):					
Operating activities	\$ 92,182	\$ 90,781	\$ 83,468	\$ 73,714	\$ 57,897
Investing activities	(91,540)	(92,593)	(79,635)	(79,635)	(77,969)
Financing activities	(1,953)	2,917	(2,909)	7,058	15,416
Net change in cash and cash equivalents	\$ (1,311)	\$ 1,105	\$ 924	\$ 1,137	\$ (4,656)

Selected Ratios:					
Return on average assets	5.70%	5.75%	6.02%	3.91%	3.56%
Return on average stockholders equity	11.43	11.83	12.38	7.77	6.30
Operating margin ⁽⁶⁾	57.35	58.76	60.12	62.30	61.51
Credit Quality Statistics:					
Net charge-offs	\$ 18,189	\$ 18,632	\$ 18,202	\$ 23,872	\$ 19,906
Net charge-offs as a percentage of average gross investment ⁽⁷⁾	7.65%	8.08%	8.34%	11.72%	11.28%
Provision for credit losses as a percentage of average gross	8.22	8.45	8.36	11.36	12.49

investment⁽⁷⁾

Allowance for credit losses as
a percentage of gross
investment⁽⁷⁾

6.47	5.91	5.89	6.17	7.12
------	------	------	------	------

- (1) Includes loss and damage waiver fees, service fees, interest income, and miscellaneous revenue.
- (2) Consists of receivables due in installments and estimated residual value.
- (3) Represents the amount paid to dealers upon funding of leases plus the associated unearned income.
- (4) Represents the net amount paid to dealers upon funding of leases and service contracts.

Table of Contents

- (5) Represents the aggregate of the implied interest rate on each lease originated during the period weighted by the amount funded.
- (6) Represents income before provision for income taxes and provision for credit losses as a percentage of total revenues.
- (7) Represents a percentage of average gross investment in leases.

Table of Contents

**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, INCLUDING SELECTED QUARTERLY FINANCIAL DATA
(UNAUDITED)**

The following discussion includes forward-looking statements (as such term is defined in the Private Securities Litigation Reform Act of 1995). When used in this discussion, the words may, will, expect, intend, anticipate, estimate, continue, plan and similar expressions are intended to identify forward-looking statements. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause our actual results, performance or achievements to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements are subject to risks, uncertainties and assumptions, including, among other things, those associated with:

the demand for the equipment types we finance;

our significant capital requirements;

our ability or inability to obtain the financing we need, or to use internally generated funds, in order to continue originating contracts;

the risks of defaults on our leases;

our provision for credit losses;

our residual interests in underlying equipment;

possible adverse consequences associated with our collection policy;

the effect of higher interest rates on our portfolio;

increasing competition;

increased governmental regulation of the rates and methods we use in financing and collecting on our leases and contracts;

acquiring other portfolios or companies;

dependence on key personnel;

changes to accounting standards for equipment leases;

adverse results in litigation and regulatory matters, or promulgation of new or enhanced legislation or regulations;

general economic and business conditions; and

information technology systems disruptions or security breaches.

The risk factors above and those under **Risk Factors** beginning on page 7, as well as any other cautionary language included herein, provide examples of risks, uncertainties and events that may cause our actual results to differ materially from the expectations we described in our forward-looking statements. Many of these factors are significantly beyond our control. We expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement contained herein to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based. In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained herein will in fact transpire.

Overview

We are a specialized commercial/consumer finance company that provides equipment leasing and other financing services, with a primary focus on the microticket market. Our wholly-owned operating subsidiary,

Table of Contents

TimePayment Corp, was established in June 2004. Our portfolio consists of, but is not limited to, water filtration systems, food service equipment, security equipment, point of sale (POS) cash registers, salon equipment, copiers, health care, fitness equipment and automotive repair equipment.

We derive the majority of our revenues from leases originated and held by us, payments on service and rental contracts and fee income.

We finance the origination of our leases and contracts primarily through cash provided by operating activities and borrowings under our revolving line of credit. We entered into the revolving line of credit in August 2007 with a bank syndicate led by Santander based on qualified TimePayment lease receivables. The total commitment under the facility, originally \$30 million, has been increased at various times, most recently in December 2012, when it was increased from \$100 million to \$150 million. The December 2012 amendment permits further increases in the total commitment under an accordion feature, to \$175 million, with the agreement of the Agent and, as applicable, a new or existing Lender, under certain conditions. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets. (See *Borrowings* in the **Liquidity and Capital Resources** section below for additional information.)

In a typical lease transaction, we originate a lease through our nationwide network of equipment vendors, independent sales organizations and brokers. Upon our approval of a lease application and verification that the lessee has received the equipment and signed the lease, we pay the dealer for the cost of the equipment, plus the dealer's profit margin.

Substantially all leases originated or acquired by us are non-cancelable. During the term of the lease, we are scheduled to receive payments sufficient to cover our borrowing costs and the cost of the underlying equipment and to provide us with an appropriate profit. We pass along some of the costs of our leases and contracts by charging late fees, prepayment penalties, loss and damage waiver fees and other service fees, when applicable. Collection fees are imposed based on our estimate of the cost of collection. The loss and damage waiver fees are charged if a customer fails to provide proof of insurance and are reasonably related to the cost of replacing the lost or damaged equipment or product. The initial non-cancelable term of the lease is equal to or less than the equipment's estimated economic life and often provides us with additional revenues based on the residual value of the equipment at the end of the lease. Initial terms of the leases in our portfolio generally range from 12 to 60 months, with an average initial term of 41 months as of December 31, 2013.

We also acquire service contracts under which a homeowner purchases a security system and simultaneously signs a contract with the dealer for the monitoring of that system for a monthly fee. Upon approval of the monitoring application and verification with the homeowner that the system is installed, we purchase the right to the payment stream under the monitoring service contract from the dealer at a negotiated multiple of the monthly payments. In years prior to 2012, our service contract revenue was derived from our LeaseComm portfolio, for which we have not purchased any new security service contracts since 2002. Consequently, our service contract revenue from LeaseComm represents a less significant portion of our revenue stream over time. Beginning in the second quarter of 2012, TimePayment began acquiring service contracts.

Operating Data

Dealer funding was \$90.6 million during the year ended December 31, 2013; a decrease of \$1.1 million or 1.2%, compared to the year ended December 31, 2012. Originations declined as a result of lower average contract amounts, which decreased from \$5,100 during 2012 to \$4,800 during 2013. In part, the reduction in the average contract amount was due to the increase in the number of service contract originations, for which the average amount funded was approximately \$1,200.

We continue to concentrate on our business development efforts, which include increasing the size of our vendor base and sourcing a larger number of applications from those vendors. We funded these contracts using

Table of Contents

cash provided by operating activities as well as net borrowings of \$2.2 million against our revolving line of credit. Receivables due in installments, estimated residual values, and gross investment in rental equipment and service contracts increased from \$242.3 million at December 31, 2012 to \$243.8 million at December 31, 2013, an increase of \$1.5 million, or 0.6%. Unearned income decreased by \$3.4 million, or 5.6%, from \$62.2 million at December 31, 2012, to \$58.8 million at December 31, 2013. Net cash provided by operating activities increased by \$1.4 million, or 1.5%, to \$92.2 million during the year ended December 31, 2013, from the year ended December 31, 2012.

Dealer fundings were \$91.7 million during the year ended December 31, 2012, an increase of \$13.5 million or 17.3%, compared to the year ended December 31, 2011. We funded contracts in 2012 using cash provided by operating activities as well as net borrowings of \$7.6 million against our revolving line of credit. Receivables due in installments, estimated residual values, and gross investment in rental equipment and service contracts increased from \$227.6 million at December 31, 2011, to \$242.3 million at December 31, 2012, an increase of \$14.7 million, or 6.4%. Unearned income increased by \$2.3 million, or 3.8%, from \$59.9 million at December 31, 2011, to \$62.2 million at December 31, 2012. This increase was due to the \$91.7 million in originations in 2012. Net cash provided by operating activities increased by \$7.3 million, or 8.8%, to \$90.8 million during the year ended December 31, 2012, from the year ended December 31, 2011.

Critical Accounting Policies

We consider certain of our accounting policies to be the most critical to our financial condition and results of operations in the sense that they involve the most complex or subjective decisions or assessments. We have identified our most critical accounting policies as those policies related to revenue recognition, the allowance for credit losses, income taxes and accounting for share-based compensation. These accounting policies are discussed below as well as within the notes to our consolidated financial statements.

Revenue Recognition

Our lease contracts are accounted for as financing leases. At origination, we record the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Amortization of unearned lease income and initial direct costs is suspended if, in our opinion, full payment of the contractual amount due under the lease agreement is doubtful. In conjunction with the origination of leases, we may retain a residual interest in the underlying equipment upon termination of the lease. The value of such interest is estimated at inception of the lease and evaluated periodically for impairment. At the end of the lease term, the lessee has the option to buy the equipment at the fair market value, return the equipment or continue to rent the equipment on a month-to-month basis. If the lessee continues to rent the equipment, we record our investment in the rental contract at its estimated residual value. Rental and service contract revenue are recognized based on the methodologies described below. Other revenues, such as loss and damage waiver fees and service fees relating to the leases and contracts, are recognized as they are earned.

Our investments in service contracts are recorded at cost and amortized over the expected life of the contract. Income on service contracts from monthly billings is recognized as the related services are provided. Our investment in rental contracts is either recorded at estimated residual value and depreciated using the straight-line method over a period of 12 months, or at the acquisition cost and depreciated using the straight line method over a period of 36 months. Rental income from monthly billings is recognized as the customer continues to rent the equipment. We periodically evaluate whether events or circumstances have occurred that may affect the estimated useful life or recoverability of our investments in service and rental contracts.

Table of Contents***Allowance for Credit Losses***

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Given the nature of the microticket market and the individual size of each contract, we do not have a formal credit review committee to review individual contracts. Rather, we have developed a sophisticated, multi-tiered pricing model and have automated the credit scoring, approval and collection processes. We believe that with the proper pricing model, we can grant credit to a wide range of applicants provided we have priced appropriately for the associated risk. As a result of approving a wide range of credits, we experience a relatively high level of delinquency and write-offs in our portfolio. We periodically review the credit scoring and approval process to ensure that the automated system is making appropriate credit decisions. Given the nature of the microticket market and the individual size of each contract, we do not evaluate contracts individually for the purpose of developing and determining the adequacy of the allowance for credit losses. Contracts in our portfolio are not re-graded subsequent to the initial extension of credit and the allowance is not allocated to specific contracts. Rather, we view the contracts as having common characteristics and maintain a general allowance against our entire portfolio utilizing historical collection statistics and an assessment of current credit risk in the portfolio as the basis for the amount.

Each period, the provision for credit losses in the consolidated statements of income results from the combination of an estimate by management of credit losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods. To serve as a basis for making this provision, we have adopted a consistent, systematic procedure for establishing and maintaining an appropriate allowance for credit losses for our contracts. We estimate the likelihood of credit losses net of recoveries in the portfolio at each reporting period based upon a combination of an internally-developed proprietary scoring model that considers several factors including the lessee's bureau-reported credit score at contract inception and the current delinquency status of the account. In addition to these elements, we also consider other relevant factors including general economic trends, trends in delinquencies and credit losses, static pool analysis of our portfolio, trends in recoveries made on charged off accounts, and other relevant factors which might affect the performance of our portfolio. This combination of historical experience, credit scores, delinquency levels, trends in credit losses, and the review of current factors provides the basis for our analysis of the adequacy of the allowance for credit losses. In general, a receivable is deemed uncollectable when it is 360 days past due or earlier if other adverse events occur with respect to an account. None of our receivables are placed on non-accrual status as contracts are charged off when deemed uncollectible. Historically, the typical monthly payment under our microticket contracts has been small and as a result, our experience is that lessees will pay past due amounts later in the process because of the relatively small amount necessary to bring a contract current.

Income Taxes

Significant judgment is required in determining the provision for income taxes, deferred tax assets and liabilities, and the valuation allowance recorded against net deferred tax assets. The process involves summarizing temporary differences resulting from the different treatment of items, such as leases, for tax and accounting purposes. In addition, our income tax calculations involve the application of complex tax regulations in a multitude of jurisdictions. Differences between the basis of assets and liabilities result in deferred tax assets and liabilities, which are recorded on the balance sheet. We must then assess the likelihood that deferred tax assets will be recovered from future taxable income or tax carry-back availability and to the extent management believes recovery is more likely than not, a valuation allowance is unnecessary.

In accordance with U.S. GAAP, uncertain tax positions taken or expected to be taken in a tax return are subject to potential financial statement recognition based on prescribed recognition and measurement criteria. Based on our evaluation, we concluded that there are no significant uncertain tax positions requiring recognition in our financial

statements. At December 31, 2013, there have been no material changes to the liability for uncertain tax positions and there are no significant unrecognized tax benefits. It is reasonably possible that the

Table of Contents

total amount of unrecognized tax benefits may change significantly within the next 12 months; however at this time we are unable to estimate the change.

Share-Based Compensation

We follow the provisions of Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) Topic 718, *Compensation – Stock Compensation*, which requires the measurement of compensation cost for all outstanding unvested share-based awards at fair value and recognition of compensation over the service period for awards expected to vest. We have granted RSU awards that are based upon the achievement of specified performance targets. The estimation of stock awards that will ultimately vest requires judgment (particularly in regards to management's assessment of the likelihood of achieving the performance targets), and to the extent actual results differ from our estimates, such amounts will be recorded as a cumulative adjustment in the period estimates are revised. We estimate the fair value of stock options using a Black-Scholes valuation model, consistent with the provisions of ASC Topic 718 and Securities and Exchange Commission, (SEC) Staff Accounting Bulletin No. 107 *Share Based Payments*. Key input assumptions used to estimate the fair value of stock options include the expected option term, volatility of our stock, the risk-free interest rate and our dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards, and subsequent events are not indicative of the reasonableness of the original estimates of fair value made by us under ASC Topic 718.

Non-employee stock-based compensation is accounted for in accordance with FASB ASC Topic 505, *Equity-based payments to non-employees*. In accordance with this topic, cost recognized for non-employee share-based payment transactions is determined by the fair value of whichever is more reliably measurable: (a) the goods or services received; or (b) the equity instruments issued.

Results of Operations***Revenues***

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Income on financing leases	\$ 41,153	2.9%	\$ 40,008	8.0%	\$ 37,032
Rental income	10,534	8.2%	9,737	13.6%	8,574
Income on service contracts	936	141.2%	388	-2.5%	398
Loss and damage waiver fees	5,859	8.8%	5,385	9.3%	4,929
Service fees and other	4,036	6.3%	3,798	1.6%	3,740
Total revenues	\$ 62,518	5.4%	\$ 59,316	8.5%	\$ 54,673

Our lease contracts are accounted for as financing leases. At origination, we record the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Other revenues such as loss and damage waiver fees, service fees relating to the leases and contracts, and rental revenues are recognized as they are earned.

Total revenues for the year ended December 31, 2013, were \$62.5 million, an increase of \$3.2 million or 5.4% from the year ended December 31, 2012. Revenue from leases was \$41.2 million, up \$1.2 million from the previous year as a result of the continued growth in the size of the portfolio due to new lease originations. Rental income was \$10.5 million, up \$0.8 million from 2012, and income from service contracts was \$0.9 million, an increase of \$0.5 million from 2012. Other revenue components contributed \$9.9 million, up \$0.7 million from the previous year in connection with the increased size in our portfolio. The increase in rental income is the result of TimePayment lease contracts coming to term and converting to rentals, partially offset by the attrition of

Table of Contents

LeaseComm and TimePayment rental contracts. Beginning in the second quarter of 2012, TimePayment began acquiring service contracts, resulting in an increase in service contract revenue. The increase in fees and other income relates to increases in loss and damage waiver fees and various service fees billed.

Total revenues for the year ended December 31, 2012, were \$59.3 million, an increase of \$4.6 million or 8.5% from the year ended December 31, 2011. Revenue from leases was \$40.0 million, up \$3.0 million from the previous year as a result of the continued growth in new lease originations. Rental income was \$9.7 million, up \$1.2 million from 2011. Other revenue components contributed \$9.6 million, up \$0.5 million from the previous year in connection with the increased size in our portfolio. The increase in rental income is the result of TimePayment's lease contracts coming to term and converting to rentals, partially offset by the attrition of LeaseComm rental contracts.

Selling, General and Administrative

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Selling, general and administrative	\$ 18,514	6.0%	\$ 17,466	10.0%	\$ 15,873
As a percent of revenue	29.6%		29.4%		29.0%

Our selling, general and administrative (SG&A) expenses include costs of maintaining corporate functions such as accounting, finance, collections, legal, human resources, sales and underwriting and information systems. SG&A expenses also include commissions, service fees and other marketing costs associated with our portfolio of leases, rentals and service contracts. SG&A expenses increased by \$1.0 million or 6.0%, for the year ended December 31, 2013, as compared to the year ended December 31, 2012. The increase was primarily driven by increases in compensation-related expenses of \$0.5 million, bank service charges of \$0.1 million and service contract monitoring fees of \$0.1 million. The number of employees as of December 31, 2013, was 155 compared to 152 as of December 31, 2012.

SG&A expenses increased by \$1.6 million or 10.0%, for the year ended December 31, 2012, as compared to the year ended December 31, 2011. Significant factors in the increase of the SG&A expense include increases in compensation-related expenses of \$1.4 million, an increase in postage costs of \$109,000 and an increase in marketing and promotion costs of \$85,000. The number of employees as of December 31, 2012, was 152 compared to 135 as of December 31, 2011.

Provision for Credit Losses

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Provision for credit losses	\$ 19,530	0.2%	\$ 19,490	6.8%	\$ 18,250
As a percent of revenue	31.2%		32.9%		33.4%

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Our provision for credit losses increased \$40,000 or 0.2%, for the year ended December 31, 2013, as compared to the year ended December 31, 2012, while net charge-offs decreased by 2.4% to \$18.2 million. The provision was based on providing a general allowance on leases funded during the year and our analysis of actual and expected losses in our portfolio. The allowance as a percentage of the net lease receivables was 9.9% and 9.3% at December 31, 2013 and 2012,

respectively. Net lease receivables consist of receivables due in installments, reduced by unearned income. The increase in the allowance as a percentage of the net lease receivables reflects the higher delinquency levels of the lease portfolio.

Our provision for credit losses increased by \$1.2 million or 6.8%, for the year ended December 31, 2012, as compared to the year ended December 31, 2011. Net charge-offs increased by \$0.4 million to \$18.6 million, or

Table of Contents

2.4%, for the year ended December 31, 2012, as compared to the year ended December 31, 2011. The provision was based on providing a general allowance on leases funded during the year and our analysis of actual and expected losses in our portfolio as a whole. The decrease in the allowance as a percentage of revenue reflects improvements in delinquency levels of the lease portfolio.

Depreciation and Amortization

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Depreciation property and equipment	\$ 609	1.8%	\$ 598	17.3%	\$ 510
Depreciation rental equipment	4,339	18.2%	3,671	33.0%	2,760
Amortization service contracts	500	481.4%	86	100.0%	
Total depreciation and amortization	\$ 5,448	25.1%	\$ 4,355	33.2%	\$ 3,270

As a percent of revenue

	8.7%	7.3%	6.0%
--	------	------	------

Depreciation and amortization expense consists of depreciation on property and equipment and rental equipment, and the amortization of service contracts. Property and equipment are recorded at cost and depreciated over their expected useful lives. Most of our rental contracts are originated as a result of the renewal provisions of our lease agreements where at the end of the lease term, the customer may elect to continue to rent the leased equipment on a month-to-month basis. The rental equipment is recorded at its residual value and depreciated over a term of 12 months. This term represents the estimated life of a previously leased piece of equipment and is based upon our historical experience. In the event the contract terminates prior to the end of the 12 month period, the remaining net book value is expensed. Investments in service contracts are amortized over the term of the contract. In the event the contract terminates prior to its contractual term, the remaining net book value is expensed.

Depreciation on property and equipment increased by \$11,000, or 1.8%, for the year ended December 31, 2013, as compared to the year ended December 31, 2012. Depreciation expense on rentals increased by \$0.7 million, or 18.2%, in for the year ended December 31, 2013, compared to the same period in 2012. The increase in depreciation is due to the increase in the number of TimePayment lease contracts reaching maturity and converting to rentals, along with the acceleration of depreciation on rental contracts that were terminated during the period. Terminated contracts include buyouts, returns and write-offs. The carrying value of our rental equipment increased from \$1.0 at December 31, 2012, to \$1.1 million at December 31, 2013. Amortization expense on service contracts increased by \$0.4 million, or 481.4%, in 2013 due to an increased level of new service contract originations compared to 2012, as TimePayment only began to acquire service contracts in the second quarter of 2012. The carrying value of our service contracts increased from \$0.8 million at December 31, 2012, to \$2.1 million at December 31, 2013.

Depreciation expense on rentals increased by \$0.9 million, or 33.0%, in 2012 in connection with the increase in the TimePayment rental portfolio, along with the acceleration of depreciation on rental contracts that were written off during the period. The carrying value of our rental equipment increased from \$0.9 million at December 31, 2011, to \$1.0 million at December 31, 2012. The carrying value of our service contracts increased from \$0 at December 31, 2011, to \$0.8 million at December 31, 2012, due to the addition of new TimePayment service contracts. Depreciation on property and equipment increased by \$88,000, or 17.3%, for the year ended December 31, 2012, as compared to the year ended December 31, 2011.

Interest Expense

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Interest	\$ 2,703	2.4%	\$ 2,639	-0.8%	\$ 2,661
As a percent of revenue	4.3%		4.4%		4.9%

-25-

Table of Contents

We pay interest on borrowings under our revolving line of credit. Interest expense increased by \$64,000 or 2.4% for the year ended December 31, 2013, as compared to the year ended December 31, 2012. This increase resulted primarily from an increase in the level of borrowings on our revolving line of credit, partially offset by a reduction in interest rates. At December 31, 2013, the balance on our revolving line of credit was \$72.6 million compared to \$70.4 million at December 31, 2012. The interest rates on our loans at December 31, 2013, were between 2.74% and 4.00%, as compared to interest rates between 2.96% and 4.00% during the prior year.

Interest expense decreased by \$22,000 or 0.8% for the year ended December 31, 2012, as compared to the year ended December 31, 2011. This decrease resulted primarily from a reduction in interest rates, offset by an increase in the level of borrowing on our revolving line of credit. At December 31, 2012, the balance on our revolving line of credit was \$70.4 million compared to \$62.7 million at December 31, 2011. The interest rate on our loans during the year ended December 31, 2012, were between 2.96% and 4.0%, as compared to interest rates between 3.13% and 4.5% during the prior year.

Provision for Income Taxes

	2013	Change	2012	Change	2011
	<i>(Dollars in thousands)</i>				
Provision for income taxes	\$ 6,560	9.1%	\$ 6,015	6.9%	\$ 5,628
As a percent of revenue	10.5%		10.1%		10.3%
As a percent of income before taxes	40.2%		39.1%		38.5%

The provision for income taxes, deferred tax assets and liabilities and any necessary valuation allowance recorded against net deferred tax assets involves summarizing temporary differences resulting from the different treatment of items, such as leases, for tax and accounting purposes. These differences result in deferred tax assets and liabilities which are recorded on the balance sheet. We then assess the likelihood that deferred tax assets will be recovered from future taxable income or tax carry-back availability and, to the extent we believe recovery is more likely than not, a valuation allowance is unnecessary.

The provision for income taxes increased by \$0.5 million, or 9.1%, for the year ended December 31, 2013, as compared to the year ended December 31, 2012. This increase resulted primarily from the \$1.0 million increase in income before income taxes, combined with an increase in the effective tax rate from 39.1% at December 31, 2012, to 40.2% at December 31, 2013, due to the utilization of federal and certain state net operating loss carry-forwards in prior periods that are no longer available.

The provision for income taxes increased by \$0.4 million, or 6.9%, for the year ended December 31, 2012, as compared to the year ended December 31, 2011. This increase resulted primarily from the \$0.7 million increase in income before income taxes, combined with an increase in the effective tax rate from 38.5% at December 31, 2011, to 39.1% at December 31, 2012, due to the utilization of federal and certain state net operating loss carry-forwards in prior periods that are no longer available.

Table of Contents**Selected Quarterly Data**

The following is a summary of our unaudited quarterly results of operations for 2013 and 2012. This unaudited quarterly information was prepared on the same basis as the audited Consolidated Financial Statements and, in the opinion of our management, reflects all necessary adjustments, consisting only of normal recurring items, necessary for a fair presentation of the information for the periods presented. The quarterly operating results are not necessarily indicative of future results of operations, and you should read them in conjunction with the audited Consolidated Financial Statements and Notes thereto included elsewhere in this Annual Report on Form 10-K.

	2013				2012			
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	<i>(Unaudited)</i>							
	<i>(Dollars in thousands)</i>							
Revenues:								
Income on leases	\$ 10,204	\$ 10,359	\$ 10,303	\$ 10,287	\$ 9,635	\$ 9,920	\$ 10,160	\$ 10,293
Rental income	2,503	2,682	2,660	2,689	2,317	2,402	2,462	2,556
Income on service contracts	176	214	250	296	85	85	95	123
Loss and damage waiver fees	1,441	1,446	1,474	1,498	1,287	1,321	1,370	1,407
Service fees and other	971	973	1,056	1,036	920	967	950	961
Total revenues	15,295	15,674	15,743	15,806	14,244	14,695	15,037	15,340
Expenses:								
Selling, general and administrative	4,662	4,841	4,618	4,393	4,356	4,025	4,466	4,619
Provision for credit losses	4,881	4,743	4,790	5,116	4,896	4,548	4,847	5,199
Depreciation and amortization	1,305	1,310	1,355	1,478	1,008	1,065	1,083	1,199
Interest	670	660	679	694	633	655	747	604
Total expenses	11,518	11,554	11,442	11,681	10,893	10,293	11,143	11,621
Income before provision for income taxes	3,777	4,120	4,301	4,125	3,351	4,402	3,894	3,719
Provision for income taxes	1,511	1,654	1,721	1,674	1,340	1,761	1,587	1,327
Net income	\$ 2,266	\$ 2,466	\$ 2,580	\$ 2,451	\$ 2,011	\$ 2,641	\$ 2,307	\$ 2,392
Net income per common share								
basic	\$ 0.16	\$ 0.17	\$ 0.18	\$ 0.17	\$ 0.14	\$ 0.18	\$ 0.16	\$ 0.17
	0.15	0.17	0.18	0.16	0.14	0.18	0.16	0.16

Net income per common share diluted									
Dividends declared per common share	0.06	0.06	0.06	0.07	0.06	0.06	0.06	0.06	0.06

Table of Contents**Exposure to Credit Losses**

The amounts in the table below represent the balance of delinquent receivables on an exposure basis for all leases, rental contracts and service contracts in our portfolio as of December 31, 2013, 2012 and 2011. An exposure basis aging classifies the entire receivable based on the invoice that is the most delinquent. For example, in the case of a rental or service contract, if a receivable is 90 days past due, all amounts billed and unpaid are placed in the over 90 days past due category. In the case of lease receivables, where the minimum contractual obligation of the lessee is booked as a receivable at the inception of the lease, if a receivable is 90 days past due, the entire receivable, including all amounts billed and unpaid as well as the minimum contractual obligation yet to be billed, will be placed in the over 90 days past due category.

	2013		As of December 31, 2012		2011	
			<i>(dollars in thousands)</i>			
Current	\$ 180,419	84.1%	\$ 179,887	84.3%	\$ 170,038	84.8%
31-60 days past due	7,171	3.3	7,601	3.6	6,600	3.3
61-90 days past due	4,932	2.3	5,825	2.7	4,324	2.2
Over 90 days past due	22,106	10.3	20,153	9.4	19,537	9.7
Receivables due in installments	\$ 214,628	100.0%	\$ 213,466	100.0%	\$ 200,499	100.0%

Liquidity and Capital Resources*General*

Our lease and finance business is capital-intensive and requires access to substantial short-term and long-term credit to fund lease originations. Since inception, we have funded our operations primarily through borrowings under our credit facilities, on-balance sheet securitizations, the issuance of subordinated debt, cash provided by operating activities and the proceeds from our initial public offering completed in February 1999. We will continue to require significant additional capital to maintain and expand our funding of leases and contracts, as well as to fund any future acquisitions of leasing companies or portfolios. In the near term, we expect to finance our business utilizing cash on hand, cash provided by operating activities and borrowings on our revolving line of credit which matures in December 2016. Additionally, our uses of cash include the payment of interest and principal on borrowings, selling, general and administrative expenses, income taxes, payment of dividends and capital expenditures.

For the years ended December 31, 2013, 2012 and 2011, our primary sources of liquidity were cash provided by operating activities and borrowings on our revolving line of credit. We generated cash flow from operations of \$92.2 million for the year ended December 31, 2013; \$90.8 million for the year ended December 31, 2012; and \$83.5 million for the year ended December 31, 2011.

Net cash used in investing activities was \$91.5 million for the year ended December 31, 2013; \$92.6 million for the year ended December 31, 2012, and \$79.6 million for the year ended December 31, 2011. Investing activities primarily relate to the origination of leases with investments in lease and service contracts, direct costs, property, and equipment.

Net cash used in financing activities was \$2.0 million for the year ended December 31, 2013. Net cash provided by financing activities was \$2.9 million for the year ended December 31, 2012. Net cash used in financing activities was \$2.9 million for the year ended December 31, 2011. Financing activities includes borrowings from and repayments on our various financing sources. During 2013, we borrowed \$136.9 million from our revolving credit facility, and repaid \$134.7 million. During 2012, we borrowed \$129.2 million and repaid \$121.5 million. During 2011, we borrowed \$106.4 million and repaid \$106.4 million. During 2013, 2012 and 2011, we paid dividends of \$3.6 million, \$3.4 million, and \$3.0 million, and we used \$0.7 million, \$0, and \$0.2 million, respectively, to repurchase our common stock.

Table of Contents

At December 31, 2013, we had approximately \$72.6 million outstanding on our revolving line of credit facility, and had available borrowing capacity of approximately \$77.4 million as described below. The maturity date of our revolving line of credit is December 2016, at which time the outstanding loan balance plus interest becomes due and payable. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan.

We believe that cash flows from our existing portfolio, cash on hand, available borrowings on the existing credit facility, and additional financing as required will be sufficient to support our operations and lease origination activity in the near term.

Borrowings

We utilize our revolving line of credit to fund the origination and acquisition of leases that satisfy the eligibility requirements established pursuant to the facility. Borrowings outstanding consist of the following as of:

	December 31, 2013			December 31, 2012			Maximum Facility Amount
	Amounts Outstanding	Interest Rate	Unused Capacity	Amounts Outstanding	Interest Rate	Unused Capacity	
Revolving credit facility (1)	\$ 72,566	2.74% - 4.0%	\$ 77,434	\$ 70,380	2.96% - 4.0%	\$ 79,620	\$ 150,000

(Dollars in Thousands)

(1) The unused capacity is subject to the borrowing base formula.

We entered into the revolving line of credit in August 2007 with a bank syndicate led by Santander based on qualified TimePayment lease receivables. The total commitment under the facility, originally \$30 million, has been increased at various times, most recently in December 2012, from \$100 million to \$150 million. In addition, the December 2012 amendment permits further increases in the total commitment under an accordion feature, to \$175 million, with the agreement of the Agent and, as applicable, a new or existing Lender, under certain conditions. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets. In connection with the most recent amendment, the maturity date of the facility was extended to December 2016.

The following table demonstrates the total commitment under the revolving credit facility with the associated rate options in effect during the three year periods ended December 31, 2013, 2012 and 2011. As of December 31, 2013, the total commitment under the facility was \$150 million.

Amendment Date	Total Commitment under Credit Facility <i>(in millions)</i>	Rate options ⁽¹⁾	Minimum Rate	Facility Expiration
July 2010	\$ 100	Prime plus 1.25% or LIBOR plus 3.25%	None	August 2013

Edgar Filing: MICROFINANCIAL INC - Form 10-K

October 2011	100	Prime plus 0.75%	or	LIBOR plus 2.75%	None	August 2014
December 2012	150	Base ⁽²⁾ plus 0.75%	or	LIBOR plus 2.50%	None	December 2016

- (1) Under the terms of the facility, loans are Base Rate Loans (or prior to December 2012, Prime Rate Loans), unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity it automatically converts to a Base Rate Loan.
- (2) The Base Rate is the highest of the prime rate established by the Agent, or one-month LIBOR plus 1%, or the federal funds effective rate plus 0.5%.

Table of Contents

At December 31, 2013, \$65.0 million of our loans were LIBOR Loans and \$7.6 million of our loans were Base Rate Loans. As of December 31, 2013, the qualified lease receivables eligible under the borrowing base computation were approximately \$129.9 million.

Financial Covenants

Our revolving line of credit has financial covenants that we must comply with in order to obtain funding through the facility and to avoid an event of default. These include requirements that we (i) maintain a ratio of our consolidated net earnings before interest, taxes and non-recurring non-cash items, as calculated under the agreement, to our consolidated interest expense of not less than 1.75:1 as of the end of any fiscal quarter for the four preceding quarters; (ii) maintain a consolidated tangible capital base (defined to mean our consolidated tangible net worth, as calculated under the agreement, plus subordinated debt) of not less than 90% of our consolidated tangible capital base at September 30, 2012, which will be adjusted upward for subsequent quarterly periods by 50% of our net income plus 100% of any equity capital we receive; (iii) maintain a leverage ratio (defined to mean the ratio of consolidated total liabilities, less subordinated debt, to consolidated tangible net worth, plus subordinated debt) at any time to not exceed 3.5 to 1.0; and (iv) not permit receivables over 90 days past due to exceed 18.75% of gross lease installments. The revolving line of credit also contains other affirmative and negative covenants, including restrictions on our ability to incur or guaranty indebtedness, dispose of or acquire assets or engage in a merger transaction, or make certain restricted payments. As of December 31, 2013, we were in compliance with all covenants in our borrowing relationships.

Contractual Obligations and Lease Commitments

The following table summarizes our contractual cash obligations at December 31, 2013, (including our future minimum lease payments under non-cancelable operating leases), and the effect such obligations are expected to have on our liquidity and cash flow in future periods (in thousands):

Payments due by December 31,	Revolving line of credit	Operating lease obligations	Total
2014	\$ 72,566	\$ 712	\$ 73,278
2015		728	728
2016		744	744
2017		760	760
2018		421	421
Thereafter			
Total	\$ 72,566	\$ 3,365	\$ 75,931

Contractual Obligations

We have entered into various agreements, such as debt and operating lease agreements, which require future payments. During the year ended December 31, 2013, we had borrowed \$136.9 million against our revolving line of credit and had repaid \$134.7 million. The \$72.6 million of outstanding borrowings as of December 31, 2013, will be repaid by the daily application of TimePayment receipts to our outstanding balance and thus is presented in the table above as due in 2014. The facility matures in December 2016.

Lease Commitments

We accept lease applications on a daily basis and have a pipeline of applications that have been approved, where a lease has not been originated. Our commitment to lend does not become binding until all of the steps in the lease origination process have been completed, including but not limited to the receipt of a complete and accurate lease document, all required supporting information and successful verification with the lessee. Since we fund on the same day a lease is successfully verified, we have no firm outstanding commitments to lend.

Table of Contents

Market Risk and Financial Instruments

The following discussion about our risk management activities includes forward-looking statements that involve risk and uncertainties. Actual results could differ materially from those projected in the forward-looking statements. In the normal course of operations, we also face risks that are either non-financial or non-quantifiable. Such risks principally include credit risk and legal risk, and are not represented in the analysis that follows.

The implicit yield on all of our leases and contracts is on a fixed interest rate basis due to the leases and contracts having scheduled payments that are fixed at the time of origination. When we originate or acquire leases or contracts, we base our pricing in part on the spread we expect to achieve between the implicit yield on each lease or contract and the effective interest rate we expect to incur in financing such lease or contract through our credit facility. Increases in interest rates during the term of each lease or contract could narrow or eliminate the spread, or result in a negative spread.

Given the relatively short average life of our leases and contracts, our philosophy is to maintain a blend of fixed and variable interest rate obligations, whenever feasible, in order to limit our interest rate risk. Based on our assessment of current market conditions, we have determined that the cost associated with obtaining fixed rate debt would exceed the benefits associated with mitigating the current interest rate risk. Accordingly we currently have no fixed-rate obligations; however, our variable interest rate obligations under our revolving line of credit are tied to several LIBOR contracts with varying maturity dates ranging from 30 days to 180 days in duration. As of December 31, 2013, we have \$72.6 million of outstanding variable interest rate obligations under our revolving line of credit.

Our revolving line of credit bears interest at rates which fluctuate with changes in the Prime or the LIBOR; therefore, our interest expense is subject to changes in market interest rates. However, the effect of a 10% adverse change in market interest rates, sustained for one year, on our interest expense would be immaterial.

We maintain an investment portfolio in accordance with our investment policy guidelines. The primary objectives of the investment guidelines are to preserve capital, maintain sufficient liquidity to meet our operating needs, and to maximize return. We minimize investment risk by limiting the amount invested in any single security and by focusing on conservative investment choices with short terms and high credit quality standards. We do not use derivative financial instruments or invest for speculative trading purposes. There was no investment activity in 2013 or 2012.

Recently Issued Accounting Pronouncements

On August 17, 2010, the International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) released a joint exposure draft that would dramatically change lease accounting for both lessees and lessors by requiring balance sheet recognition of all leases. At their June 13, 2012, joint board meeting, the International Accounting Standards Board (IASB) and the FASB (collectively, the Boards) agreed on an approach for the accounting for lease expenses as part of their joint project to revise lease accounting. In September 2012, the Boards reached tentative decisions regarding sale and leaseback transactions and other lease accounting issues. The Boards published their revised joint proposals on leases in May 2013, consisting of the revised proposed FASB Accounting Standards Update, Leases (Topic 842) and the IASB's Exposure Draft, Leases. Following several public roundtable meetings on the revised joint proposals, the Boards plan to consider all feedback and begin re-deliberations of all significant issues during 2014.

The proposed accounting may result in a material change in our balance sheet and statements of operations because we would need to discount our investments to their net present values. Additionally, the proposed regulations would change the accounting treatment required of lessees. The Boards have modified the initial proposals based upon

feedback from stakeholders regarding front-loading of expense recognition for lessees. However, should the final rules be perceived negatively by business owners, it could result in reduced demand for equipment leases and could have an adverse effect on our results of operation and financial condition.

Table of Contents

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

See Item 7, under the caption Market Risk and Financial Instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our Financial Statements, together with the related report of our Independent Registered Public Accounting Firm, appear on pages F-1 through F-28 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure controls and procedures

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act. Based upon the evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act. Internal control over financial reporting is defined as a process designed by, or under the supervision of, our executive officers and effected by our board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

Under the supervision and with the participation of our management, including our executive officers, we assessed as of December 31, 2013, the effectiveness of our internal control over financial reporting. This assessment was based on criteria established in the Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission established in 1992. Based on our assessment using those criteria, our management concluded that our internal control over financial reporting as of December 31, 2013, was effective.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by our registered public accounting firm pursuant to the rules of the Securities and Exchange Commission that permit us to provide only management's report in this annual report.

Change in Internal Control over Financial Reporting

During the fourth quarter of our fiscal year ended December 31, 2013, no changes were made in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

ITEM 9B. OTHER INFORMATION

Not applicable.

Table of Contents**PART III****ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information appearing in our proxy statement for the 2014 Special Meeting in Lieu of Annual Meeting of Stockholders to be filed on or before April 30, 2014, (the 2014 Proxy Statement), under the headings, Section 16(a) Beneficial Ownership Reporting Compliance, Governance of the Corporation and Election of Directors, is hereby incorporated by reference. The information under the heading Executive Officers in Part I, Item 1 of this Annual Report on Form 10-K is also incorporated by reference in this item.

ITEM 11. EXECUTIVE COMPENSATION

The information appearing in our 2014 Proxy Statement under the headings Executive Compensation and Compensation of Directors is hereby incorporated by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information appearing in our 2014 Proxy Statement under the heading Security Ownership of Certain Beneficial Owners and Management is hereby incorporated by reference.

The following table summarizes information, as of December 31, 2013, relating to our equity compensation plans pursuant to which grants of options, restricted stock, restricted stock units or other rights to acquire shares may be granted from time to time.

Equity Compensation Plan Information

Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options and Rights (a)	Weighted-Average Exercise Price of Outstanding Options and Rights⁽²⁾ (b)	Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)
Equity compensation plans approved by security holders ⁽¹⁾	560,279	\$ 3.72	613,183
Equity compensation plans not approved by security holders			

Total	560,279	\$	3.72	613,183
-------	---------	----	------	---------

- (1) Includes our 2008 Equity Incentive Plan (which was approved by our stockholders at the 2008 special meeting of stockholders in lieu of annual meeting) and our 2012 Equity Incentive Plan (which was approved by our stockholders at the 2012 special meeting of stockholders in lieu of annual meeting). No shares remain available for future issuance under the 2008 Equity Incentive Plan. The number of securities available for future issuance under the 2012 Equity Incentive Plan will be reduced by three for each share of restricted stock or other full share award made to an employee, and by one for any option granted to an employee or for any award made to non-employee directors.
- (2) Weighted average exercise price of outstanding options; excludes restricted stock.

Table of Contents

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information appearing in our 2014 Proxy Statement under the headings "Governance of the Corporation - Certain Relationships and Related Person Transactions" and "Determination of Director Independence" is hereby incorporated by reference.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information appearing in our 2014 Proxy Statement under the heading "Ratification of the Selection of MicroFinancial's Independent Registered Public Accounting Firm" is hereby incorporated by reference.

Table of Contents**PART IV****ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

- (a)(1) Financial Statements Our Financial Statements, together with the related report of the Independent Registered Public Accounting Firm, appear at pages F-1 through F-28 of this Form 10-K
- (2) None
- (3) Exhibits Index

Exhibit Number	Description
3.1	Restated Articles of Organization, as amended. Incorporated by reference to Exhibit 3.1 in the Registrant's Registration Statement on Form S-1 (Registration Statement No. 333-56639) filed with the Securities and Exchange Commission on June 9, 1998.
3.2	Restated Bylaws, as amended. Incorporated by reference to Exhibit 3.2 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2007.
10.1	Warrant Purchase Agreement dated April 14, 2003, among the Registrant, Fleet National Bank, as agent, and the other Lenders named therein. Incorporated by reference to Exhibit 10.2 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2003.
10.2	Form of Warrants to purchase Common Stock of the Registrant issued April 14, 2003. Incorporated by reference to Exhibit 10.3 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2003.
10.3	Co-Sale Agreement dated April 14, 2003, among the Registrant, Peter R. Bleyleben, Torrence C. Harder, Brian E. Boyle, Richard F. Latour, Alan J. Zakon, and James R. Jackson, Jr., and the Lenders named therein. Incorporated by reference to Exhibit 10.4 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2003.
10.4	Registration Rights Agreement dated April 14, 2003, among the Registrant and the Lenders named therein. Incorporated by reference to Exhibit 10.5 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2003.
10.5	Office lease for the Burlington facility at 16 New England Executive Park, Suite 200, Burlington, MA dated September 20, 2010, among MicroFinancial Incorporated and MA-New England Executive Park, LLC. Incorporated by reference to Exhibit 10.2 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on November 15, 2010.
10.6.1*	MicroFinancial Incorporated 1998 Equity Incentive Plan. Incorporated by reference to Exhibit 10.12 in the Registrant's Amendment No. 2 to Registration Statement on Form S-1 (Registration Statement

Edgar Filing: MICROFINANCIAL INC - Form 10-K

No. 333-56639) filed with the Securities and Exchange Commission on January 11, 1999.

- 10.6.2* MicroFinancial Incorporated 2008 Equity Incentive Plan. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed with the Securities and Exchange Commission on May 16, 2008.
- 10.6.3* MicroFinancial Incorporated 2012 Equity Incentive Plan. Incorporated by reference to Exhibit 99.1 in the Registrant's registration Statement on Form S-8, No. 333-182818, filed with the Securities and Exchange Commission on July 24, 2012.
- 10.6.4* Form of incentive stock option agreement. Incorporated by reference to Exhibit 10.6.3 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2007.

Table of Contents

Exhibit Number	Description
10.6.5*	Form of non-qualified stock option agreement. Incorporated by reference to Exhibit 10.6.4 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2007.
10.6.6*	Form of restricted stock unit (RSU) agreement. Incorporated by reference in Exhibit 10.6.6 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2010.
10.6.7*	Form of performance-based restricted stock unit (RSU) agreement. Incorporated by reference to Exhibit 10.6.5 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on May 15, 2012.
10.7*	Compensatory Arrangements for Non-Employee Directors. Incorporated by reference to Exhibit 10.7 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 29, 2013.
10.8.1*	Amended and Restated Employment Agreement between the Registrant and Richard F. Latour dated March 15, 2004. Incorporated by reference to Exhibit 10.8 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2007.
10.8.2*	Amendment to Employment Agreement between the Registrant and Richard F. Latour dated December 24, 2008. Incorporated by reference to Exhibit 10.8.2 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2009.
10.9*	Amended and Restated Employment Agreement between the Registrant and James R. Jackson, Jr. dated February 1, 2013. Incorporated by reference to Exhibit 10.1 in the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 4, 2013.
10.10.1*	Employment Agreement between the Registrant and Stephen Constantino dated May 4, 2005. Incorporated by reference to Exhibit 10.4 in the Registrant's Quarterly Report on Form 10-Q filed with the Securities and Exchange Commission on August 12, 2005.
10.10.2*	Amendment to Employment Agreement between the Registrant and Stephen Constantino dated December 24, 2008. Incorporated by reference to Exhibit 10.10.2 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2009.
10.11*	Amended and Restated Employment Agreement between the Registrant and Steven LaCreta dated February 1, 2012. Incorporated by reference to Exhibit 10.2 in the Registrant's Current Report on Form 8-K filed with the Securities and Exchange Commission on February 4, 2013.
10.12*	Offer Letter dated November 23, 2011, by and between TimePayment Corp. and Vartan Hagopian. Incorporated by reference to Exhibit 10.11.2 in the Registrant's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 31, 2012.
10.13.1	Credit Agreement dated August 2, 2007. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.2	Unlimited Guaranty of Registrant dated August 2, 2007. Incorporated by reference to Exhibit 10.2 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.3	Unlimited Guaranty of LeaseComm dated August 2, 2007. Incorporated by reference to Exhibit 10.3 in the Registrant's Form 8-K filed on August 8, 2007.

Edgar Filing: MICROFINANCIAL INC - Form 10-K

- 10.13.4 Security Agreement between TimePayment Corp. and Agent dated August 2, 2007. Incorporated by reference to Exhibit 10.4 in the Registrant's Form 8-K filed on August 8, 2007.
- 10.13.5 Security Agreement between Registrant and Agent dated August 2, 2007. Incorporated by reference to Exhibit 10.5 in the Registrant's Form 8-K filed on August 8, 2007.

-37-

Table of Contents

Exhibit Number	Description
10.13.6	Security Agreement between LeaseComm and Agent dated August 2, 2007. Incorporated by reference to Exhibit 10.6 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.7	Trademark Security Agreement and License dated August 2, 2007, by TimePayment Corp. Incorporated by reference to Exhibit 10.7 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.8	Trademark Security Agreement and License dated August 2, 2007, by Registrant. Incorporated by reference to Exhibit 10.8 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.9	Trademark Security Agreement and License dated August 2, 2007, by LeaseComm. Incorporated by reference to Exhibit 10.9 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.10	Pledge Agreement of Registrant dated August 2, 2007. Incorporated by reference to Exhibit 10.10 in the Registrant's Form 8-K filed on August 8, 2007.
10.13.11	Amended and Restated Credit Agreement dated July 9, 2008. Incorporated by reference to Exhibit 10.10 in the Registrant's Form 8-K filed on July 15, 2008.
10.13.12	Agreement and Amendment No. 1 to Amended and Restated Credit Agreement dated February 10, 2009. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed on February 17, 2009.
10.13.13	Agreement and Amendment No. 2, dated July 28, 2010, to Amended and Restated Credit Agreement dated July 9, 2008. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed on August 2, 2010.
10.13.14	Agreement and Amendment No. 3, dated October 12, 2011, to Amended and Restated Credit Agreement dated July 9, 2008. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed on October 18, 2011.
10.13.15	Second Amended and Restated Credit Agreement dated December 21, 2012. Incorporated by reference to Exhibit 10.1 in the Registrant's Form 8-K filed on December 28, 2012.
21.1	Subsidiaries of Registrant.
23.1	Consent of McGladrey LLP.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

Exhibit Number	Description
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

Filed herewith.

* Management contract or compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 14(c) of this Report.

(b) See (a) (3) above.

(c) None.

Table of Contents**SIGNATURES**

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MICROFINANCIAL INCORPORATED

By: /s/ RICHARD F. LATOUR
President and Chief Executive Officer

By: /s/ JAMES R. JACKSON JR.
Vice President and Chief Financial
Officer

Date: March 31, 2014

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

SIGNATURE	TITLE	DATE
/s/ FRITZ VON MERING Fritz Von Mering	Non-Executive Chairman and Director	March 31, 2014
/s/ RICHARD F. LATOUR Richard F. Latour	President, Chief Executive Officer, Treasurer, Clerk, Secretary and Director	March 31, 2014
/s/ JAMES R. JACKSON JR. James R. Jackson Jr.	Senior Vice President and Chief Financial Officer	March 31, 2014
/s/ PETER R. BLEYLEBEN Peter R. Bleyleben	Director	March 31, 2014
/s/ BRIAN E. BOYLE Brian E. Boyle	Director	March 31, 2014
/s/ TORRENCE C. HARDER Torrence C. Harder	Director	March 31, 2014

/s/ ALAN J. ZAKON

Director

March 31, 2014

Alan J. Zakon

-40-

Table of Contents

MICROFINANCIAL INCORPORATED

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

<u>Report of Independent Registered Public Accounting Firm</u>	F-2
Financial Statements:	
<u>Consolidated Balance Sheets as of December 31, 2013 and 2012</u>	F-3
<u>Consolidated Statements of Operations for the Years Ended December 31, 2013, 2012 and 2011</u>	F-4
<u>Consolidated Statements of Stockholders' Equity for the Years Ended December 31, 2011, 2012 and 2013</u>	F-5
<u>Consolidated Statements of Cash Flows for the Years Ended December 31, 2013, 2012 and 2011</u>	F-6
<u>Notes to Consolidated Financial Statements</u>	F-8

F-1

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

MicroFinancial Incorporated:

Burlington, Massachusetts

We have audited the accompanying consolidated balance sheets of MicroFinancial Incorporated and subsidiaries as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of MicroFinancial Incorporated and subsidiaries as of December 31, 2013 and 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013, in conformity with U.S. generally accepted accounting principles.

/s/ McGladrey LLP

Boston, Massachusetts

March 31, 2014

Table of Contents**MICROFINANCIAL INCORPORATED****CONSOLIDATED BALANCE SHEETS***(In thousands, except share and per share data)*

ASSETS		
	December 31,	
	2013	2012
Cash and cash equivalents	\$ 2,246	\$ 3,557
Restricted cash	1,107	1,213
Net investment in leases:		
Receivables due in installments	214,628	213,466
Estimated residual value	23,070	24,176
Initial direct costs	1,732	1,751
Less:		
Advance lease payments and deposits	(3,010)	(3,278)
Unearned income	(58,772)	(62,244)
Allowance for credit losses	(15,379)	(14,038)
Net investment in leases	162,269	159,833
Investment in service contracts, net	2,058	797
Investment in rental contracts, net	1,059	1,037
Property and equipment, net	1,333	1,534
Other assets	2,980	1,658
Total assets	\$ 173,052	\$ 169,629
LIABILITIES AND STOCKHOLDERS EQUITY		
	December 31,	
	2013	2012
Revolving line of credit	\$ 72,566	\$ 70,380
Accounts payable	2,993	3,220
Dividends payable	63	40
Other liabilities	2,272	2,545
Income taxes payable		653
Deferred income taxes	6,678	10,399
Total liabilities	84,572	87,237
Commitments and contingencies (Note M)		
Stockholders equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; no shares issued at December 31, 2013 and 2012		
	144	145

Edgar Filing: MICROFINANCIAL INC - Form 10-K

Common stock, \$.01 par value; 25,000,000 shares authorized; 14,435,498 and 14,470,219 shares issued and outstanding at December 31, 2013, and 2012, respectively		
Additional paid-in capital	47,475	47,500
Retained earnings	40,861	34,747
Total stockholders' equity	88,480	82,392
Total liabilities and stockholders' equity	\$ 173,052	\$ 169,629

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

F-3

Table of Contents

MICROFINANCIAL INCORPORATED
CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data)

	Year Ended December 31,		
	2013	2012	2011
Revenues:			
Income on financing leases	\$ 41,153	\$ 40,008	\$ 37,032
Rental income	10,534	9,737	8,574
Income on service contracts	936	388	398
Loss and damage waiver fees	5,859	5,385	4,929
Service fees and other	4,036	3,798	3,740
Total revenues	62,518	59,316	54,673
Expenses:			
Selling, general and administrative	18,514	17,466	15,873
Provision for credit losses	19,530	19,490	18,250
Depreciation and amortization	5,448	4,355	3,270
Interest	2,703	2,639	2,661
Total expenses	46,195	43,950	40,054
Income before provision for income taxes	16,323	15,366	14,619
Provision for income taxes	6,560	6,015	5,628
Net income	\$ 9,763	\$ 9,351	\$ 8,991
Net income per common share basic	\$ 0.68	\$ 0.65	\$ 0.63
Net income per common share diluted	\$ 0.66	\$ 0.64	\$ 0.62
Weighted average shares outstanding basic	14,460,613	14,321,815	14,247,413
Weighted average shares outstanding diluted	14,774,529	14,689,531	14,525,566
Dividends declared per common share	\$ 0.25	\$ 0.24	\$ 0.21

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

Table of Contents

MICROFINANCIAL INCORPORATED
CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Years Ended December 31, 2011, 2012 and 2013

(In thousands, except share and per share data)

	Common Stock		Additional Paid-in Retained Capital	Earnings	Total Stockholders Equity
	Shares	Amount			
Balance at December 31, 2010	14,231,933	\$ 142	\$ 46,475	\$ 22,870	\$ 69,487
Stock issued for director compensation	77,274	1	353		354
Stock-based compensation			138		138
Repurchase of common stock	(51,883)		(239)		(239)
Common stock dividends (\$0.21 per share)				(3,008)	(3,008)
Net income				8,991	8,991
Balance at December 31, 2011	14,257,324	143	46,727	28,853	75,723
Stock issued for director compensation	48,148		346		346
Stock-based compensation			191		191
Shares issued upon vesting of restricted stock units	8,380				
Warrants exercised	6,367				
Stock options exercised	150,000	2	236		238
Common stock dividends (\$0.24 per share)				(3,457)	(3,457)
Net income				9,351	9,351
Balance at December 31, 2012	14,470,219	145	47,500	34,747	82,392
Stock issued for director compensation	45,792		361		361
Stock-based compensation			232		232
Shares issued upon vesting of restricted stock units	16,640				
Repurchase of common stock	(97,153)	(1)	(707)		(708)
Excess tax benefits from share-based compensation			89		89
Common stock dividends (\$0.25 per share)				(3,649)	(3,649)
Net income				9,763	9,763
Balance at December 31, 2013	14,435,498	\$ 144	\$ 47,475	\$ 40,861	\$ 88,480

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

Table of Contents

MICROFINANCIAL INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

	Year Ended December 31,		
	2013	2012	2011
Cash flows from operating activities:			
Cash received from customers	\$ 130,847	\$ 121,839	\$ 106,298
Cash paid to suppliers and employees	(24,086)	(21,694)	(19,594)
Cash paid for income taxes	(12,092)	(6,983)	(791)
Excess tax benefits from share-based compensation	(89)		
Interest paid	(2,398)	(2,381)	(2,446)
Interest received			1
Net cash provided by operating activities	92,182	90,781	83,468
Cash flows from investing activities:			
Investment in lease and service contracts	(89,710)	(90,777)	(77,684)
Investment in direct costs	(1,461)	(1,595)	(1,120)
Investment in property and equipment	(369)	(221)	(831)
Net cash used in investing activities	(91,540)	(92,593)	(79,635)
Cash flows from financing activities:			
Proceeds from revolving line of credit	136,933	129,180	106,446
Repayment of revolving line of credit	(134,747)	(121,540)	(106,356)
Payments of debt closing costs		(693)	(112)
(Increase) decrease in restricted cash	106	(831)	371
Repayment of capital leases		(1)	(25)
Repurchase of common stock	(708)		(239)
Proceeds from stock option exercises		238	
Excess tax benefits from share-based compensation	89		
Payment of dividends	(3,626)	(3,436)	(2,994)
Net cash (used in) provided by financing activities	(1,953)	2,917	(2,909)
Net change in cash and cash equivalents	(1,311)	1,105	924
Cash and cash equivalents, beginning	3,557	2,452	1,528
Cash and cash equivalents, ending	\$ 2,246	\$ 3,557	\$ 2,452

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

Table of Contents

MICROFINANCIAL INCORPORATED
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in thousands)

(Continued)

	Year Ended December 31,		
	2013	2012	2011
Reconciliation of net income to net cash provided by operating activities:			
Net income	\$ 9,763	\$ 9,351	\$ 8,991
Adjustments to reconcile net income to net cash provided by operating activities:			
Amortization of unearned income, net of initial direct costs	(41,153)	(40,008)	(37,032)
Depreciation and amortization	5,448	4,355	3,270
Provision for credit losses	19,530	19,490	18,250
Recovery of equipment cost and residual value	104,237	96,970	84,267
Stock-based compensation expense	232	191	138
Excess tax benefits from share-based compensation	(89)		
(Decrease) increase in deferred income taxes liability	(3,721)	(934)	3,706
Changes in assets and liabilities:			
(Increase) decrease in other assets	(1,322)	128	599
Increase in accounts payable	134	1,020	465
(Decrease) increase in other liabilities	(313)	325	54
(Decrease) increase in income taxes payable	(564)	(107)	760
Net cash provided by operating activities	\$ 92,182	\$ 90,781	\$ 83,468
Supplemental disclosure of non-cash activities:			
Fair value of stock issued for compensation	\$ 361	\$ 346	\$ 354
Acquisition of property and equipment through lease incentives	\$ 39	\$	\$ 791
Non-cash transfer of leases to rentals	\$ 4,360	\$ 3,810	\$ 836

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

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

A. Nature of Business

MicroFinancial Incorporated (referred to as MicroFinancial, we, us or our) operates primarily through its wholly-owned subsidiaries, TimePayment Corp. and LeaseComm Corporation. TimePayment is a specialized commercial/consumer finance company that leases and rents equipment and provides other financing services, with a primary focus on the microticket market. LeaseComm originated leases from January 1986 through October 2002, and continues to service its remaining contract portfolio. TimePayment commenced originating leases in July 2004, and began acquiring security monitoring service contracts in the second quarter of 2012. We primarily source our originations through a nationwide network of independent equipment vendors, sales organizations and other dealer-based origination networks. We fund our operations through cash provided by operating activities and borrowings under our revolving line of credit.

B. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of MicroFinancial and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

Segment Reporting

We operate in one industry segment that leases and rents microticket equipment and provides other financing services. All of our operations are located in the United States. Accordingly, we believe we have a single reportable segment for disclosure purposes.

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 reported period. Significant areas requiring the use of management estimates are revenue recognition, the allowance for credit losses, share-based payments and income taxes. Actual results could differ from those estimates.

Cash and Cash Equivalents

We consider all highly liquid instruments purchased with original maturities of less than three months to be cash equivalents. Cash equivalents consist principally of overnight investments, collateralized repurchase agreements, commercial paper, certificates of deposit and US government and agency securities. As of December 31, 2013 and 2012, our cash equivalents consisted of overnight investments. Cash equivalents are stated at cost, which approximates fair value.

Restricted Cash

Our line of credit requires that all TimePayment cash receipts be deposited into a cash collateral account held by Santander Bank (formerly known as Sovereign Bank) (Santander). These funds are applied directly to amounts outstanding under the line of credit as they clear. Those funds which are pending clearance and application against the line of credit are deemed to be restricted.

F-8

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

Revenue Recognition

Our lease contracts are accounted for as financing leases. At origination, we record the gross lease receivable, the estimated residual value of the leased equipment, initial direct costs incurred and the unearned lease income. Unearned lease income is the amount by which the gross lease receivable plus the estimated residual value exceeds the cost of the equipment. Unearned lease income and initial direct costs incurred are amortized over the related lease term using the interest method. Amortization of unearned lease income and initial direct costs is suspended and the contract written off, if, in our opinion, full payment of the contractual amount due under the lease agreement is doubtful. In conjunction with the origination of leases, we may retain a residual interest in the underlying equipment upon termination of the lease. The value of such interest is estimated at inception of the lease and evaluated periodically for impairment. At the end of the lease term, the lessee has the option to buy the equipment at the fair market value (buyouts), return the equipment or continue to rent the equipment on a month-to-month basis. If the lessee continues to rent the equipment, we record our investment in the rental contract at its estimated residual value. Rental income from monthly billings is recognized as the customer continues to rent the equipment. We also acquire service contracts under which a homeowner purchases a security system and simultaneously signs a contract with the dealer for the monitoring of that system for a monthly fee. We purchase the right to the payment stream under the monitoring contract from the dealer. Income on service contracts from monthly billings is recognized as the related services are provided. Other revenues, such as loss and damage waiver fees and service fees relating to the leases and contracts, are recognized as they are earned.

Allowance for Credit Losses and Credit Quality

We maintain an allowance for credit losses on our investment in leases, service contracts and rental contracts at an amount that we believe is sufficient to provide adequate protection against losses in our portfolio. Given the nature of the microticket market and the individual size of each contract, we do not have a formal credit review committee to review individual contracts. Rather, we have developed a sophisticated, multi-tiered pricing model and have automated the credit scoring, approval and collection processes. We believe that with the proper pricing model, we can grant credit to a wide range of applicants provided we have priced appropriately for the associated risk. As a result of approving a wide range of credits, we experience a relatively high level of delinquency and write-offs in our portfolio. We periodically review the credit scoring and approval process to ensure that the automated system is making appropriate credit decisions. Given the nature of the microticket market and the individual size of each contract, we do not evaluate contracts individually for the purpose of developing and determining the adequacy of the allowance for credit losses. Contracts in our portfolio are not re-graded subsequent to the initial extension of credit and the allowance is not allocated to specific contracts. Rather, we view the contracts as having common characteristics and maintain a general allowance against our entire portfolio utilizing historical collection statistics and an assessment of current credit risk in the portfolio as the basis for the amount.

Each period, the provision for credit losses in the consolidated statements of income results from the combination of an estimate by management of credit losses that occurred during the current period and the ongoing adjustment of prior estimates of losses occurring in prior periods. To serve as a basis for making this provision, we have adopted a

consistent, systematic procedure for establishing and maintaining an appropriate allowance for credit losses for our contracts. We estimate the likelihood of credit losses net of recoveries in the portfolio at each reporting period based upon a combination of an internally-developed proprietary scoring model that considers several factors including the lessee's bureau-reported credit score at contract inception and the current delinquency status of the account. In addition to these elements, we also consider other relevant factors including general economic trends, actual historical losses, trends in delinquencies and credit losses, static pool analysis of our portfolio, trends in recoveries made on charged off accounts, and other relevant factors which

F-9

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

might affect the performance of our portfolio. This combination of historical experience, credit scores, delinquency levels, trends in credit losses, and the review of current factors provides the basis for our analysis of the adequacy of the allowance for credit losses. In general, a receivable is deemed uncollectable when it is 360 days past due or earlier if other adverse events occur with respect to an account. None of our receivables are placed on non-accrual status as contracts are charged off when deemed uncollectible. Historically, the typical monthly payment under our microticket contracts has been small and as a result, our experience is that lessees will pay past due amounts later in the process because of the relatively small amount necessary to bring a contract current.

We segregate our contract portfolio between TimePayment and LeaseComm to perform the calculation and analysis of the allowance for credit losses. Each subsidiary consists of a single portfolio segment – microticket equipment. Leases of microticket equipment and other contracts are made to businesses and individuals and are generally secured by assets of the business or a personal guarantee. Repayment is expected from the cash flows of the business or individual. A weakened economy, and resultant decreased consumer spending, may have a negative effect on the credit quality in this segment.

We assign internal risk ratings for all lessees and determine the creditworthiness of each contract based upon this internally-developed proprietary scoring model. The LeaseComm portfolio is evaluated in total, with a reserve calculated based upon the aging of the portfolio and our collection experience. The TimePayment scoring model generates one of ten acceptable risk ratings based upon the creditworthiness of each application or it rejects the application. The scores are assigned at contract inception, and these scores are maintained over the contract term regardless of payment performance. To facilitate review and reporting, management aggregates these ten scores into one of three categories with similar risk profiles and delinquency characteristics identified as Gold, Silver or Bronze.

Contracts assigned a Gold rating represent those transactions which exhibit the best risk rating based on our internal credit scores. They are considered of sufficient quality to preclude an otherwise adverse rating. Gold rated contracts are typically represented by lessees with high bureau-reported credit scores for personal guarantors at contract inception or are supported by established businesses for those transactions which are not personally guaranteed by the lessee.

Contracts assigned a Silver rating fall in the middle range of the ten acceptable scores generated by the scoring model. These transactions possess a reasonable amount of risk based on their profile and may exhibit vulnerability to deterioration if adverse factors are encountered. These contracts typically demonstrate adequate coverage but warrant a higher level of monitoring by management to ensure that weaknesses do not advance.

A Bronze rating applies to contracts at the lower end of the ten acceptable scores generated by the scoring model whereby the lessee may have difficulty meeting the contract obligation if adverse factors are encountered. Bronze rated contracts typically have lower reported credit scores at contract inception and will typically have other less desirable credit attributes.

See Note C for details of our allowance for credit losses and the aged analysis of past due financing receivables based upon our internally-developed proprietary scoring model.

Investment in Service Contracts

Our investments in service contracts are recorded at cost and amortized over the term of the contract. Upon retirement or other disposition, the cost and related accumulated amortization are removed from the accounts and any resulting gain or loss is reflected in income. We periodically evaluate whether events or circumstances have

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

occurred that may affect the estimated useful life or recoverability of our investment in service contracts. Prior to 2012, our service contract revenue was derived from our LeaseComm portfolio, for which we have not purchased any new security service contracts since 2002. Beginning in the second quarter of 2012, TimePayment began acquiring service contracts.

Investment in Rental Contracts

Our investment in rental contracts is either recorded at estimated residual value for converted leases and depreciated using the straight-line method over a period of twelve months or recorded at the acquisition cost and depreciated using the straight line method over an estimated life of three years. Rental equipment consists of a wide variety of low-priced commercial equipment with similar characteristics. Upon retirement or other disposition, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in income. Dispositions include equipment buyouts, returns and write-offs. We periodically evaluate whether events or circumstances have occurred that may affect the estimated useful life or recoverability of the investment in rental contracts.

Property and Equipment

Office and computer equipment are recorded at cost and depreciated using the straight-line method over estimated lives of approximately three to five years. Leasehold improvements are amortized over the shorter of the life of the lease or the estimated life of the improvement. Upon retirement or other disposition, the cost and related accumulated depreciation of the assets are removed from the accounts and any resulting gain or loss is reflected in income.

Fair Value of Financial Instruments

Accounting for fair value measurements involves a single definition of fair value, along with a conceptual framework to measure fair value, with fair value defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement hierarchy consists of three levels:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs developed using estimates and assumptions which are developed by the reporting entity and reflect those assumptions that a market participant would use.

We apply valuation techniques that (1) place greater reliance on observable inputs and less reliance on unobservable inputs and (2) are consistent with the market approach, the income approach and/or the cost approach.

The carrying values of cash and cash equivalents, restricted cash, other assets, accounts payable and other liabilities approximate their fair values due to the short maturity of these instruments. The fair value of the amounts outstanding under our revolving line of credit, evaluated using Level 2 inputs as of December 31, 2013 and 2012, approximated the carrying value.

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

Debt Issue Costs

Costs incurred in securing financing are capitalized in other assets and amortized over the term of the financing, which is considered the interval from the current date until the expiration of the credit facility. When we modify our revolving line of credit, we evaluate the arrangement in accordance with Financial Accounting Standard Board (FASB) Accounting Standards Codification (ASC) Topic 470, *Line-of-Credit or Revolving-Debt Arrangements*. In accordance with this guidance, if the borrowing capacity of the new arrangement is greater than or equal to the borrowing capacity of the old arrangement, then any unamortized deferred costs, any fees paid to the creditor, and any third-party costs incurred shall be associated with the new arrangement (that is, deferred and amortized over the term of the new arrangement).

Income Taxes

The Company accounts for income taxes in accordance with FASB ASC Topic 740, *Income Taxes*. FASB ASC Topic 740 prescribes the use of the liability method whereby deferred tax asset and liability account balances are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The Company provides a valuation allowance, if necessary, to reduce deferred tax assets to their estimated realizable value.

FASB ASC Topic 740 clarifies the accounting for income taxes, by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on derecognition, measurement and classification of amounts relating to uncertain tax positions, accounting for and disclosure of interest and penalties, accounting in interim periods, disclosures and transition relating to the adoption of the new accounting standard.

Net Income per Common Share

Basic net income per common share is computed based on the weighted-average number of common shares outstanding during the period. Diluted net income per common share gives effect to all potentially dilutive common shares outstanding during the period. The computation of diluted net income per share does not assume the issuance of common shares that have an antidilutive effect on net income per common share.

Stock-Based Employee Compensation

We have adopted the fair value recognition provisions of FASB ASC Topic 718, *Compensation – Stock Compensation*. FASB ASC Topic 718 requires us to recognize the compensation cost related to share-based payment transactions with employees in the financial statements. The compensation cost is measured at the grant date based on the fair value of the award and is recognized as an expense as it is earned over the requisite service period, which is the vesting period. Share-based compensation transactions with employees covered by FASB ASC Topic 718 include

share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans.

We estimate the fair value of stock options using a Black-Scholes valuation model and a 0% expected forfeiture rate, consistent with the provisions of FASB ASC Topic 718 and Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 107 Share Based Payments. Key input assumptions used to estimate the fair value of stock options include the expected option term, volatility of the stock, the risk-free interest rate and the dividend yield.

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Tables in thousands, except percentages, share and per share data)

The expected life represents the average period of time that the options are expected to be outstanding given consideration to vesting schedules; annualized volatility is based on historical volatilities of our common stock; dividend yield represents the current dividend yield expressed as a constant percentage of our stock price and the risk-free interest rate is based on the U.S. Treasury yield curve in effect on the measurement date for periods corresponding to the expected life of the option.

Restricted stock units (RSUs) are valued at the stock price at date of grant, and expensed ratably over the performance period or vesting period, as appropriate. The number of performance-based RSUs for which stock compensation expense is calculated is based upon management's assessment of the likelihood of achieving the performance targets.

Non-employee stock-based compensation is accounted for in accordance with FASB ASC Topic 505, *Equity-based payments to non-employees*. In accordance with this topic, cost recognized for non-employee share-based payment transactions is determined by the fair value of whichever is more reliably measurable: (a) the goods or services received; or (b) the equity instruments issued.

Lease Obligation and Deferred Rent

We lease our facilities, located in Massachusetts and California, under multi-year operating lease agreements. We account for these leases in accordance with FASB ASC Topic 840, *Leases*. In connection with these two lease agreements, we received landlord incentives for build out expenses incurred. The incentive or allowance is recorded as deferred rent and amortized as a reduction to lease expense over the initial lease terms. Rent expense is recorded on a straight-line basis.

Concentration of Credit Risk

Our financial instruments that are exposed to concentration of credit risk consist primarily of lease and rental receivables and cash and cash equivalent balances. To reduce our risk, credit policies are in place for approving leases and the lease pools are monitored by us. In addition, cash and cash equivalents are maintained at high-quality financial institutions.

Financial instruments that subject us to concentrations of credit risk principally consist of cash equivalents and deposits in bank accounts. We deposit our cash and invest in short-term investments primarily through national commercial banks. Deposits in excess of amounts insured by the Federal Deposit Insurance Corporation (FDIC) are exposed to loss in the event of nonperformance by the institution. The Company has had cash deposits in excess of the FDIC insurance coverage. However, we have not experienced any losses in such accounts.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)***C. Net Investment in Leases***Future Minimum Lease Payments*

At December 31, 2013, future minimum payments due on our lease receivables are as follows:

Year Ending December 31,	
2014	\$ 105,117
2015	61,058
2016	32,293
2017	12,958
2018	3,202
Total	\$ 214,628

At December 31, 2013, the weighted-average remaining life of the leases in our portfolio was approximately 26 months, and their weighted-average implicit rate of interest was approximately 25.5%. At December 31, 2012, the weighted-average remaining life of the leases in our portfolio was approximately 28 months, and their weighted-average implicit rate of interest was approximately 25.9%.

Estimated Residual Value

A summary of the changes in estimated residual value is as follows:

	Year Ended December 31,		
	2013	2012	2011
Estimated residual value, beginning	\$ 24,176	\$ 23,287	\$ 21,832
Lease originations	7,574	8,737	8,279
Terminations	(8,680)	(7,848)	(6,824)
Estimated residual value, ending	\$ 23,070	\$ 24,176	\$ 23,287

Originations represent the residual value capitalized upon origination of leases and terminations represent the residual value deducted upon the termination of a lease that (i) is bought out during or at the end of the lease term, (ii) has completed its original lease term and converted to an extended rental contract, (iii) has been charged off by us, or (iv) has been returned to us and recorded as inventory.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)**Allowance for Credit Losses and Credit Quality*

The following table reconciles the activity in the allowance for credit losses by portfolio segment for the years ended December 31, 2013, 2012 and 2011:

	Microticket Equipment		
	LeaseComm	TimePayment	Total
Allowance for credit losses at January 1, 2010:	\$ 231	\$ 12,901	\$ 13,132
Charge-offs	(726)	(22,437)	(23,163)
Recoveries	1,221	3,740	4,961
Provisions	(564)	18,814	18,250
Allowance for credit losses at December 31, 2011	162	13,018	13,180
Charge-offs	(605)	(23,185)	(23,790)
Recoveries	248	4,910	5,158
Provisions	298	19,192	19,490
Allowance for credit losses at December 31, 2012	103	13,935	14,038
Charge-offs	(361)	(23,876)	(24,237)
Recoveries	162	5,886	6,048
Provisions	187	19,343	19,530
Allowance for credit losses at December 31, 2013	\$ 91	\$ 15,288	\$ 15,379

The following table presents the allowance for credit losses and financing receivables by portfolio segment as of December 31, 2013 and 2012, classified according to impairment evaluation method:

	As of December 31, 2013			As of December 31, 2012		
	Lease-Comm	Time-Payment	Total	Lease-Comm	Time-Payment	Total
Allowance for credit losses:						
Individually evaluated for impairment	\$	\$	\$	\$	\$	\$

Edgar Filing: MICROFINANCIAL INC - Form 10-K

Collectively evaluated for impairment	91	15,288	15,379	103	13,935	14,038
Contracts acquired with deteriorated credit quality						
Ending balance, allowance for credit losses	\$ 91	\$ 15,288	\$ 15,379	\$ 103	\$ 13,935	\$ 14,038
Financing receivables: ⁽¹⁾						
Individually evaluated for impairment	\$	\$	\$	\$	\$	\$
Collectively evaluated for impairment	185	177,463	177,648	174	173,697	173,871
Contracts acquired with deteriorated credit quality						
Ending balance, financing receivables ⁽¹⁾	\$ 185	\$ 177,463	\$ 177,648	\$ 174	\$ 173,697	\$ 173,871

(1) Total financing receivables include net investment in leases. For purposes of asset quality and allowance calculations, the allowance for credit losses is excluded.

F-15

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

The following table presents the aging status of the recorded investment in leases as of December 31, 2013, classified according to the original score granted by our internally-developed proprietary scoring model:

	Current	31 to 60 Days Past Due	61 to 90 Days Past Due	Over 90 Days Past Due	Total	Over 90 Days Accruing
LeaseComm	\$ 93	\$ 5	\$ 4	\$ 83	\$ 185	\$ 83
TimePayment						
Gold	58,769	2,501	902	3,391	65,563	3,391
Silver	81,152	2,933	2,754	13,437	100,276	13,437
Bronze	7,788	493	502	2,841	11,624	2,841
TimePayment subtotal	147,709	5,927	4,158	19,669	177,463	19,669
Total financing receivables	\$ 147,802	\$ 5,932	\$ 4,162	\$ 19,752	\$ 177,648	\$ 19,752

Percent of total financing
receivables

83.2% 3.3% 2.4% 11.1% 100%

The following table presents the aging status of the recorded investment in leases as of December 31, 2012, classified according to the original score granted by our internally-developed proprietary scoring model:

	Current	31 to 60 Days Past Due	61 to 90 Days Past Due	Over 90 Days Past Due	Total	Over 90 Days Accruing
LeaseComm	\$ 90	\$ 5	\$ 5	\$ 74	\$ 174	\$ 74
TimePayment						
Gold	54,446	2,763	1,042	2,309	60,560	2,309
Silver	84,268	2,883	3,281	13,312	103,744	13,312
Bronze	6,341	493	441	2,118	9,393	2,118
TimePayment subtotal	145,055	6,139	4,764	17,739	173,697	17,739
Total financing receivables	\$ 145,145	\$ 6,144	\$ 4,769	\$ 17,813	\$ 173,871	\$ 17,813

Percent of total financing
receivables

83.5% 3.5% 2.7% 10.3% 100%

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)***D. Net Income per Common Share**

Net income per common share for the twelve months ended December 31, 2013, 2012 and 2011 was as follows:

	Year Ended December 31,		
	2013	2012	2011
Net income	\$ 9,763	\$ 9,351	\$ 8,991
Weighted-average shares outstanding used in computation of net income per share basic	14,460,613	14,321,815	14,247,413
Dilutive effect of options, warrants and restricted stock	313,916	367,716	278,153
Shares used in computation of net income per common share assuming dilution	14,774,529	14,689,531	14,525,566
Net income per common share basic	\$ 0.68	\$ 0.65	\$ 0.63
Net income per common share diluted	\$ 0.66	\$ 0.64	\$ 0.62

We excluded 0, 0, and 409,305 options from the computation of diluted net income per share for the twelve month periods ended December 31, 2013, 2012 and 2011, respectively, because their effect would have been antidilutive.

E. Debt Issue Costs

During the years ended December 31, 2013, 2012 and 2011, we recognized interest expense related to the amortization of debt issuance costs of \$288,000, \$216,000, and \$282,000, respectively. In 2012, we amended our revolving line of credit and increased our borrowing capacity. In accordance with FASB ASC Topic 470, *Line-of-Credit or Revolving-Debt Arrangements*, we adjusted our amortization of unamortized deferred costs such that they would be amortized over the term of the arrangement.

F. Property and Equipment

At December 31, 2013 and 2012, our property and equipment consisted of the following:

	December 31,	
	2013	2012
Computer equipment	\$ 3,719	\$ 3,449
Office equipment	363	319
Leasehold improvements	1,269	1,175
Total	5,351	4,943
Less accumulated depreciation and amortization	(4,018)	(3,409)
Property and equipment, net	\$ 1,333	\$ 1,534

Additions to leasehold improvements during the years ended December 31, 2013 and 2012, included \$39,000 and \$0, respectively, in landlord incentives relating to our California office.

F-17

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

Depreciation and amortization expense were as follows for the years ended December 31, 2013, 2012 and 2011:

	Twelve months ended December 31,		
	2013	2012	2011
Depreciation and amortization expense relating to:			
Property and equipment	\$ 609	\$ 598	\$ 510
Rental equipment	4,339	3,671	2,760
Service contracts	500	86	
Total depreciation and amortization	\$ 5,448	\$ 4,355	\$ 3,270

G. Investment in Service Contracts, net

At December 31, 2013 and 2012, our investment in service contracts consisted of the following:

	December 31,	
	2013	2012
Investment in service contracts	\$ 3,079	\$ 1,495
Less accumulated amortization	(1,021)	(698)
Investment in service contracts, net	\$ 2,058	\$ 797

H. Investment in Rental Contracts, net

At December 31, 2013 and 2012, our investment in rental contracts consisted of the following:

	December 31,	
	2013	2012
Investment in rental contracts	\$ 2,985	\$ 3,163
Less accumulated depreciation	(1,926)	(2,126)
Investment in rental contracts, net	\$ 1,059	\$ 1,037

I. Revolving Line of Credit

Our revolving line of credit balance was \$72,566,000 and \$70,380,000 at December 31, 2013 and 2012, respectively.

We entered into the revolving line of credit in August 2007 with a bank syndicate led by Santander based on qualified TimePayment lease receivables. The total commitment under the facility, originally \$30 million, has been increased at various times, most recently from \$100 million to \$150 million in December 2012. The December 2012 amendment also permits further increases in the total commitment under an accordion feature, to \$175 million, with the agreement of the Agent and, as applicable, a new or existing Lender, under certain conditions. Outstanding borrowings are collateralized by eligible lease contracts and a security interest in all of our other assets.

At December 31, 2013, we had available borrowing capacity of approximately \$77.4 million. Our available borrowing capacity was subject to limitations based on lease eligibility and a borrowing base formula.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

The revolving line of credit has financial covenants that we must comply with to obtain funding and avoid an event of default. As of December 31, 2013, we were in compliance with all covenants under the revolving line of credit.

The maturity date of our revolving line of credit is December 2016, at which time the outstanding loan balance plus interest becomes due and payable. At our option upon maturity, the unpaid principal balance may be converted to a six-month term loan.

The following table demonstrates the total commitment under the revolving credit facility with the associated rate options in effect during the three years ended December 31, 2013. As of December 31, 2013, the total commitment under the facility was \$150 million.

Amendment Date	Total Commitment under Credit Facility (in millions)	Rate options⁽¹⁾			Minimum Rate	Facility Expiration
July 2010	\$ 100	Prime plus 1.25%	or	LIBOR plus 3.25%	None	August 2013
October 2011	100	Prime plus 0.75%	or	LIBOR plus 2.75%	None	August 2014
December 2012	150	Base ⁽²⁾ plus 0.75%	or	LIBOR plus 2.50%	None	December 2016

(1) Under the terms of the facility, loans are Based Rate Loans (or prior to December 2012, Prime Rate Loans), unless we elect LIBOR Loans. If a LIBOR Loan is not renewed at maturity it automatically converts to a Base Rate Loan.

(2) The base rate is the highest of the prime rate established by the Agent, or one-month LIBOR plus 1%, or the federal funds effective rate plus 0.5%.

At December 31, 2013, \$65.0 million of our loans were LIBOR loans and \$7.6 million of our loans were Base Rate Loans. The interest rate on our loans at December 31, 2013, was between 2.74% and 4.00%. At the same date, the qualified lease receivables eligible under the borrowing base computation were approximately \$129.9 million.

J. Dividends

Dividends declared and paid or payable were as follows:

2013

Date Declared	Record Date	Payment Date	Dividend per Share
January 29, 2013	February 8, 2013	February 15, 2013	\$0.06
April 23, 2013	May 3, 2013	May 15, 2013	0.06
July 17, 2013	July 30, 2013	August 15, 2013	0.06
October 24, 2013	November 4, 2012	November 15, 2013	0.07
Total			\$0.25

F-19

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

2012			Dividend per
Date Declared	Record Date	Payment Date	Share
January 31, 2012	February 10, 2012	February 15, 2012	\$0.06
April 19, 2012	April 30, 2012	May 15, 2012	0.06
July 19, 2012	July 30, 2012	August 15, 2012	0.06
October 18, 2012	October 31, 2012	November 15, 2012	0.06
Total			\$0.24

2011			Dividend per Share
Date Declared	Record Date	Payment Date	Dividend per Share
January 21, 2011	February 1, 2011	February 15, 2011	\$0.05
April 21, 2011	May 2, 2011	May 13, 2011	0.05
July 21, 2011	August 1, 2011	August 15, 2011	0.05
October 25, 2011	November 4, 2011	November 15, 2011	0.06
Total			\$0.21

K. Stockholders Equity*Warrants*

In 2003 we issued warrants to purchase common stock to our lenders in connection with a waiver of certain covenant defaults and the extension of our loan. There were no warrants exercised during 2013 or 2011. During 2012 there was a cashless exercise of 7,068 warrants which resulted in 6,367 shares being issued. As of December 31, 2013 and 2012, there were 86,221 warrants outstanding with an exercise price of \$0.815. All warrants expire on September 30, 2014. The warrant holders have certain rights and privileges that provide them with anti-dilution protection in the event that the Company issues stock at a price below the then current market price of the company's common stock.

*Stock Options and Restricted Stock**Description*

Under the MicroFinancial 2008 Equity Incentive Plan (the 2008 Plan), we reserved 1,000,000 shares of common stock for issuance, all of which had been issued as of December 31, 2013. In May 2012, our stockholders approved our 2012 Equity Incentive Plan (the 2012 Plan), for which we have 750,000 shares of common stock reserved, of which

613,183 shares are unissued as of December 31, 2013. These plans permit the Compensation and Benefits Committee of our Board of Directors to grant stock options, restricted stock, restricted stock units, shares of common stock without restrictions, and any other right to receive payment from the corporation based in whole or in part on the value of common stock. All employees and directors of the Corporation or any of its affiliates are eligible to receive awards under either plan. For purposes of calculating the shares remaining for grant under the 2012 Plan, grants of stock options or stock appreciation rights to any participant will reduce that reserve by one share for each share subject to the option or the settled portion of the stock appreciation right. Grants of restricted stock, restricted stock units and any other full share award will reduce the reserve by three shares for each share of common stock subject to the award, in the case of awards to employees, or by one share for each share of common stock subject to the award, in the case of awards to non-employee directors.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

Stock options under the plans may be incentive stock options or non-statutory stock options. The committee determines the terms of the option, including the amount, exercise price, vesting schedule and term, which may not exceed ten years. The per share exercise price of the option may not be less than 100% of the fair market value of the common stock on the grant date. No stock options granted to an employee under the plans shall become fully vested within one year of grant date and no restricted stock or other awards made to an employee without any performance-based criteria other than the employee's continued service will have a restricted vesting period of less than one year. We may not in any fiscal year grant to any participant options or other awards covering more than 200,000 shares.

Non-employee director stock grants

The following details the stock granted to our non-employee directors under the 2008 and 2012 Plans during the years ended December 31, 2013, 2012 and 2011. These shares were issued as part of our annual director compensation arrangements related to the prior years' service, and were fully vested on the date of issuance.

Date of Grant	Number of Shares	Fair Value per Share	Fair Value of Grant
February 2011	51,642	\$ 4.11	\$ 212
July 2011	25,632	5.54	142
Total 2011 Grants:	77,274		\$ 354
February 2012	31,820	6.60	\$ 210
July 2012	16,328	8.36	136
Total 2012 Grants:	48,148		\$ 346
January 2013	29,205	7.55	221
July 2013	16,587	8.44	140
Total 2013 Grants:	45,792		\$ 361

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)**Restricted Stock Unit Grants*

The following table summarizes our RSU activity for the three years ended December 31, 2013:

	Number of RSUs	Grant Date Fair Value per Share	Grant Date Fair Value	Fair Value of RSUs at Vesting Date^(a)
Unvested RSUs at December 31, 2010	33,518	\$ 3.15	\$ 106	
Granted	33,044	\$ 4.11	136	
Unvested RSUs at December 31, 2011	66,562			
Granted	40,393	\$ 6.60	266	
Vested	(8,380)			\$ 57
Unvested RSUs at December 31, 2012	98,575			
Granted	45,316	\$ 7.55	342	
Vested	(16,640)			125
Unvested RSUs at December 31, 2013	127,251		\$ 850	\$ 182

(a) The fair value of vested RSUs is calculated based on the closing stock price on the day of vesting. The fair value of unvested RSUs at December 31, 2013, based on the stock closing price on that date, was \$1.1 million, and the weighted average vesting period of these RSUs is 2.32 years.

In January 2013, the Compensation and Benefits Committee of our Board of Directors granted 45,316 RSUs to our executive officers. The RSUs were valued on the date of grant and the fair value of these awards was \$7.55 per share. The issuance consists of three separate tranches. The first tranche is for 28,643 RSUs which vest over five years at 25% annually beginning on the second anniversary of the grant date. The second tranche is for 15,548 RSUs which cliff vest after three years only if management achieves specific performance measures. The third tranche is for 1,125 RSUs which vest over five years at 25% annually, beginning on the second anniversary of the grant date, and represent payment related to 2012 incentive bonus compensation.

The RSUs granted in 2012 consist of two tranches. The first tranche is for 25,165 RSUs which vest over five years at 25% annually beginning on the second anniversary of the grant date. The second tranche is for 15,228 RSUs which

cliff vest after three years only if management achieves specific performance measures.

The RSUs granted in 2011 and 2010 vest over five years beginning on the second anniversary of the grant date.

Table of Contents

MICROFINANCIAL INCORPORATED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*(Tables in thousands, except percentages, share and per share data)**Stock Option Grants*

The following summarizes stock option activity for the years ended December 31, 2013, 2012 and 2011:

	Shares ^(b)	Exercise Price Per Share	Weighted Average Exercise Price
Outstanding at December 31, 2010	908,028	\$ 1.59 to \$13.10	\$ 5.07
Expired	(90,000)	\$ 13.10	\$ 13.10
Outstanding at December 31, 2011	818,028	\$ 1.59 to \$6.70	\$ 4.19
Exercised ^(a)	(150,000)	\$ 1.59	\$ 1.59
Expired	(235,000)	\$ 6.70	\$ 6.70
Outstanding at December 31, 2012	433,028	\$ 2.30 to \$5.85	\$ 3.72
Outstanding at December 31, 2013	433,028	\$ 2.30 to \$5.85	\$ 3.72

(a) The intrinsic value of the options exercised in 2012 was \$755,000. There were no options exercised in 2011 or 2013.

(b) The outstanding options vest over five years based solely on service and are exercisable only after they become vested. All unvested outstanding options are expected to vest. At December 31, 2013, 2012 and 2011, 368,347, 268,072 and 520,872, respectively, of the outstanding options were fully vested.

Information relating to our outstanding stock options at December 31, 2013, is as follows:

Weighted-Average Exercise Price	Outstanding			Exercisable		
	Shares	Weighted-Average Life (Years)	Intrinsic Value	Shares	Weighted-Average Life (Years)	Intrinsic Value

Edgar Filing: MICROFINANCIAL INC - Form 10-K

\$5.77	31,923	3.17	\$ 89	\$ 5.77	31,923	3.17	\$89
5.85	142,382	4.08	384	5.85	142,382	4.08	384
2.30	258,723	5.17	1,617	2.30	194,042	5.17	1,213
	433,028	4.66	\$ 2,090	\$ 3.97	368,347	4.58	\$ 1,686

Stock compensation expense recognized during the years ended December 31, 2013, 2012 and 2011, and unrecognized compensation as of December 31, 2013, are as follows:

		Year ended December 31,			Unrecognized Compensation Cost as of
		2013	2012	2011	December 31, 2013
Compensation expense	RSUs	\$ 199	\$ 109	\$ 46	\$ 476
Compensation expense	Options	33	82	92	2
Total		\$ 232	\$ 191	\$ 138	\$ 478

F-23

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

The weighted average term over which this compensation expense is expected to be recognized is 2.9 years.

Common Stock Reserved

We have reserved shares of common stock at December 31, 2013, as follows:

Warrants	86,221
Stock options	433,028
Restricted stock units	127,251
Reserved for future grants under 2012 Equity Incentive Plans	613,183
Total	1,259,683

Repurchases

On August 10, 2010, our Board of Directors approved a common stock repurchase program under which we are authorized to purchase up to 250,000 of our outstanding shares from time to time. The repurchases may take place in either the open market or through block trades. The repurchase program will be funded by our working capital and may be suspended or discontinued at any time.

During the year ended December 31, 2013, we repurchased and retired 97,153 shares of our common stock under the program, at an average price paid per share of \$7.28, for a total cost of \$708,000. During the year ended December 31, 2012, we did not repurchase any shares of our common stock under our repurchase program. During the year ended December 31, 2011, we repurchased and retired 51,883 shares of our common stock under the program, at an average price paid per share of \$4.61, for a total cost of \$239,000.

L. Income Taxes

The provision for income taxes consists of the following:

	Year Ended December 31,		
	2013	2012	2011
Current:			
Federal	\$ 8,216	\$ 5,545	\$ 789
State	2,065	1,544	1,133

Edgar Filing: MICROFINANCIAL INC - Form 10-K

	10,281	7,089	1,922
Deferred:			
Federal	(3,129)	(821)	3,994
State	(592)	(253)	(288)
	(3,721)	(1,074)	3,706
Total	\$ 6,560	\$ 6,015	\$ 5,628

F-24

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

At December 31, 2013, and 2012, the components of the net deferred tax liability were as follows:

	2013	2012
Deferred tax assets:		
Allowance for credit losses	\$ 6,152	\$ 5,615
Depreciation and amortization	32,709	29,717
State NOL and other state attributes	62	251
State valuation allowance	(205)	(355)
Total deferred tax assets	38,718	35,228
Deferred tax liabilities:		
Lease receivable and unearned income	(35,758)	(35,539)
Residual value	(9,228)	(9,670)
Initial direct costs	(410)	(418)
Total deferred tax liabilities	(45,396)	(45,627)
Net deferred tax liability	\$ (6,678)	\$ (10,399)

At December 31, 2013 and 2012, we had no federal net operating loss carry-forwards to be used to offset future income. At December 31, 2013, we had state net operating loss carry-forwards of \$2.1 million which may be used to offset future income. The state NOL s have restrictions and expire in approximately one to twenty years. We recorded a valuation allowance against some of our state net operating losses as it is unlikely that these deferred tax assets will be fully realized.

The following is reconciliation between the effective income tax rate and the applicable statutory federal income tax rate:

	Year Ended December 31,		
	2013	2012	2011
Federal statutory rate	35.0%	35.00%	35.00%
State income taxes, net of federal benefit	5.19	4.80	3.03
State valuation allowance	(0.60)	(0.06)	(0.07)
Non deductible expenses and other	0.60	(0.61)	0.54

Effective income tax rate	40.19%	39.13%	38.50%
---------------------------	--------	--------	--------

The calculation of our tax liabilities involves dealing with estimates in the application of complex tax regulations in a multitude of jurisdictions. We record liabilities for estimated tax obligations for federal and state purposes. For the years ended December 31, 2013, 2012 and 2011, the nondeductible expenses and other tax rate of 0.60%, (0.61) % and 0.54% respectively, includes certain non-deductible stock-based compensation.

Uncertain Tax Positions

As of December 31, 2013, we had no liabilities for accrued interest and penalties related to state income tax matters. As of December 31, 2012, we had liabilities of \$52,000 and \$11,000 for accrued interest and penalties, respectively, related to various state income tax matters. Of these amounts, approximately \$30,000 would impact our effective tax rate after a \$22,000 federal tax benefit for state income taxes. As of December 31, 2011, we had liabilities of \$17,000 and \$4,000 for accrued interest and penalties, respectively, related to various state income tax matters. Of these amounts, approximately \$10,000 would impact our effective tax rate after a \$4,000 federal

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

tax benefit for state income taxes. These amounts are included in income taxes payable on our balance sheet. It is reasonably possible that the total amount of unrecognized tax benefits may change significantly within the next 12 months; however at this time we are unable to estimate the change.

A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

Balance at January 1, 2011	\$ 21
Additions for tax positions related to current year	21
Reductions for tax positions as a result of lapse of statute of limitations	(21)
Balance at December 31, 2011	21
Additions for tax positions related to current year	63
Reductions for tax positions as a result of lapse of statute of limitations	(21)
Balance at December 31, 2012	63
Additions for tax positions related to current year	26
Reductions for tax positions as a result of closed examinations	(89)
Balance at December 31, 2013	\$

Our federal income tax returns are subject to examination for tax years ended on or after December 31, 2010, and our state income tax returns are subject to examination for tax years ended on or after December 31, 2009.

M. Commitments and Contingencies*Operating Leases*

On September 20, 2010, we entered into an office lease agreement for approximately 23,834 square feet of office space located in Burlington, Massachusetts. We moved our corporate headquarters to the premises in January 2011. The lease for our facility in Burlington expires in 2017.

On March 25, 2011, we entered into an office lease agreement through 2014 for approximately 2,667 square feet of office space located in California. On November 7, 2012, we amended this lease to add additional space totaling 2,319 square feet to the existing premises, and extend the term of the lease. The amended lease for the entire space is for a 64-month term, commencing in February 2013.

In connection with these two lease agreements, we received landlord incentives for build out expenses incurred. The incentive or allowance is recorded as deferred rent and amortized as a reduction to rent expense over the initial lease terms.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

At December 31, 2013, future minimum lease payments under non-cancelable operating leases are:

For the years ended December 31,	
2014	\$ 712
2015	728
2016	744
2017	760
2018	421
Total	\$ 3,365

Rental expense under operating leases for our office facilities totaled \$663,000, \$617,000 and \$610,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

Legal Matters

We are involved from time to time in litigation incidental to the conduct of our business. Although we do not expect that the outcome of any of these matters, individually or collectively, will have a material adverse effect on our financial condition or results of operations, litigation is inherently unpredictable. Therefore, judgments could be rendered or settlements entered, that could adversely affect our operating results or cash flows in a particular period. We routinely assess all of our litigation and threatened litigation as to the probability of ultimately incurring a liability, and record our best estimate of the ultimate loss in situations where we assess the likelihood of loss as probable.

Lease Commitments

We accept lease applications on a daily basis and, as a result, we have a pipeline of applications that have been approved, where a lease has not been originated. Our commitment to lend does not become binding until all of the steps in the origination process have been completed, including the receipt of the lease, supporting documentation and verification with the lessee. Since we fund on the same day a lease is verified, we have no outstanding commitments to lend.

N. Employee Benefit Plan

We have a defined contribution plan under Section 401(k) of the Internal Revenue Code to provide retirement and profit sharing benefits covering substantially all full-time employees. Employees are eligible to contribute up to 100% of their gross salary until they reach the maximum annual contribution amount allowed under the Internal Revenue Code. We match \$0.50 for every \$1.00 contributed by an employee up to 6% of the employee's salary; the maximum match is 3%. Vesting of our contributions is over a five-year period at 20% per year. Our defined contribution plan

expenses were \$122,000, \$125,000 and \$106,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

O. Concentration of Credit Risk

During the year ended December 31, 2013, 2012 and 2011, our top dealer accounted for 13.8%, 4.4% and 3.3%, respectively, of the value of leases originated. The top dealer during this three-year period was a lease broker who represents a number of equipment vendors financing a wide breadth of different equipment segments and operates on a nationwide scope.

Table of Contents**MICROFINANCIAL INCORPORATED****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS***(Tables in thousands, except percentages, share and per share data)*

TimePayment finances a wide variety of products, with water filtration systems representing approximately 25% of the amount financed in its portfolio as of December 31, 2013. No other single product represents more than 10% of the amount financed in its portfolio as of December 31, 2013.

We originate and continue to service contracts in all 50 states, the District of Columbia and Puerto Rico. The concentration of leases in certain states as of the end of each of the past three years, as a percentage of our total portfolio, is reflected below. No other state accounted for more than five percent of such total.

Year Ended

December 31,	Florida	California	Texas	New York
2011	13%	11%	8%	9%
2012	13%	12%	8%	8%
2013	13%	12%	9%	8%

P. Subsequent Events

On January 14, 2014, we declared a dividend of \$0.07 per share payable on February 14, 2014, to shareholders of record of MicroFinancial Incorporated stock on January 30, 2014.

Since December 31, 2013, we have repurchased a total of 66,552 shares of our common stock under the common stock repurchase program approved in 2010, at an average price per share of \$8.07. The total cost of the shares purchased was approximately \$537,000. The total number of shares repurchased under this program is 250,000, which represents the total shares authorized to be repurchased.

We have evaluated all events or transactions that occurred through the date on which we issued these financial statements. During this period, we did not have any material subsequent events that impacted our consolidated financial statements other than the declaration of dividends.