SMART CHOICE AUTOMOTIVE GROUP INC
Form 10-Q
September 13, 2001
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the fiscal quarter ended:
JULY 31, 2001

SMART CHOICE AUTOMOTIVE GROUP, INC.
(Exact name of registrant as specified in its charter)

FLORIDA
(State or other jurisdiction of incorporation or organization) (I.R.S.

1555 SEMORAN BLVD., WINTER PARK, FLORIDA
(Address of principal executive offices)

32792
(Zip Code)

(407) 671-1200
(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Title of Each Class
Common stock, par value $.01 per share

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PART I

ITEM 1. FINANCIAL STATEMENTS

SMART CHOICE AUTOMOTIVE GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	July 31, 2001 (unaudited)	A
Assets:		
Cash and cash equivalents	$ 850,639	$
Other receivables	1,538,885	
Finance receivables, net	143,652,925	
Inventory	9,064,511	
Prepaid and other assets	710,059	
Deferred tax assets, net	16,510,211	
Property and equipment, net	12,012,342	
Goodwill, net	2,084,017	
	$ 186,423,589	$
Liabilities and stockholders' equity:		
Accounts payable and accrued liabilities	$ 8,977,224	$
Income taxes payable	1,139,810	
Revolving credit facilities	147,441,944	
Other borrowings	9,690,208	
Deferred sales tax	4,956,653	
Total liabilities	172,205,839	
Contingent redemption value of put options	453,371	
Commitments and contingencies		
Stockholders' equity:		

Preferred stock, par value $.01 per share, 2,000,000 shares authorized; none issued or outstanding	
Common stock, par value $.01 per share, 50,000,000 shares authorized; 9,762,270 issued and outstanding	97,623
Additional paid-in capital	13,832,832
Retained earnings (accumulated deficit)	(166,076)
Total stockholders' equity	13,764,379
	$ 186,423,589

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

CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) SMART CHOICE AUTOMOTIVE GROUP, INC.

	Three Months Ended July 31, 2001	Three Months Ended July 31, 2000
Revenues:		
Sales	$ 36,591,713	$ 43,789,552
Interest income	9,647,648	9,373,066
Other	281,373	231,031
	46,520,734	53,393,649
Costs and expenses:		
Cost of sales	23,179,400	26,188,340
Selling, general and administrative	10,778,601	9,804,284
Provision for credit losses	11,052,665	10,592,204
Interest expense	3,699,925	4,198,096
Depreciation and amortization	415,133	378,667
	49,125,724	51,161,591

Income (loss) before taxes	(2,604,990)	2,232,058
Provision (benefit) for income taxes	(877,617)	829,284
Net income (loss)	$ (1,727,373)	$ 1,402,774
Earnings (loss) per share:		
Basic	$ (.18)	$ .14
Diluted	$ (.18)	$ .14
Weighted average number of shares outstanding:		
Basic	9,762,270	9,792,149
Diluted	9,762,270	9,792,149

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

CONSOLIDATED STATEMENTS OF CASH FLOWS SMART CHOICE AUTOMOTIVE GROUP, INC.
(UNAUDITED)

	Three Mon July 2001
Operating activities:	
Net income (loss)	$ (1,727,373)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:	
Depreciation and amortization	415,133
Accretion of purchase discount	(140,924)
Deferred income taxes	(905,117)
Provision for credit losses	11,052,665
Loss on sale of assets	8,959
Changes in operating assets and liabilities:	
Inventory acquired in repossession	5,577,021
Finance receivable originations	(34,133,213)

Finance receivable collections	23,647,650
Other receivables	(194,646)
Inventory	(1,084,220)
Prepaids and other assets	(102,492)
Accounts payable, accrued liabilities and deferred sales tax	(1,454,350)
Net cash provided by (used in) operating activities	959,093
Investing activities:	
Purchase of property and equipment	(269,533)
Sale of assets	20,000
Net cash used in investing activities	(249,533)
Financing activities:	
Proceeds from revolving credit facilities, net	
Repayments of other borrowings	(295,183)
Net cash provided by (used in) financing activities	(295,183)
Increase (decrease) in cash and cash equivalents	414,377
Cash and cash equivalents at: Beginning of period	436,262
End of period	$ 850,639

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS SMART CHOICE AUTOMOTIVE GROUP, INC. (UNAUDITED)

A - DESCRIPTION OF BUSINESS

Smart Choice Automotive Group, Inc. ("Smart Choice") and collectively with all of its subsidiaries (the "Company") is in the business of selling and financing used automobiles and trucks principally to consumers with limited or damaged credit histories. References to Smart Choice typically include Smart Choice Automotive Group, Inc. and its Florida based automotive and finance subsidiaries. Smart Choice also owns 100% of the outstanding common stock Paaco Automotive Group, Inc. ("Paaco"). As of July 31, 2001 Smart Choice operated 10 used car dealerships in central Florida while Paaco operated 12 used car dealerships in Texas (principally in the cities of Dallas and Houston).

B - DEFAULT ON FINOVA CREDIT FACILITY AND LIQUIDITY MATTERS

Each of Smart Choice and Paaco have revolving credit facilities with Finova Capital Corporation ("Finova"). Since December 2000 Smart Choice has been over-advanced on its revolving credit facility, which constitutes an event of default under the facility. As of July 31, 2001 Smart Choice was over-advanced by $20.9 million. Absent funding from an outside source, Smart Choice does not expect it will be able to come into compliance with the current advance rate provisions of the Finova revolving credit facility. There is uncertainty as to whether Smart Choice's event of default is the basis for an event of default under Paaco's revolving credit facility. In any event, Paaco is a wholly-owned subsidiary of Smart Choice, and ultimately Paaco could be affected by the default of Smart Choice under its Finova credit facility. As a result of the event of default, Smart Choice is currently not entitled to receive additional advances under its credit facility, and Paaco may not be entitled to receive additional advances under its credit facility.

Since January 2001 Smart Choice has been in discussions with Finova with regard to possible solutions to the over-advanced position. There are several possible outcomes that may result from these negotiations, including:

(i) a restructuring of the Smart Choice credit facility which brings Smart Choice back into compliance;

(ii) a sale of substantially all of Smart Choice's assets with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate;

(iii) an agreement among Smart Choice, Paaco and Finova whereby substantially all of the assets and liabilities of Smart Choice are liquidated with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate; or

(iv) Finova's exercise of its rights under the credit facility and acceleration of the maturity of the loan seeking to liquidate or sell the collateral, which action may prompt Smart Choice to take actions to protect the interests of its shareholders, including the filing of a plan of reorganization under federal bankruptcy laws.

Although management is exploring a number of alternatives, including those listed above, the Company cannot predict how or whether Smart Choice's default will be resolved.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. Recoverability of a significant portion of the assets shown in the accompanying balance sheet may be materially impacted if the Company ceases to continue as a going concern. The financial statements do not include any adjustments relating to the recoverability of recorded asset amounts that might be necessary should the Company be unable to continue in existence.

C - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended July 31, 2001 are not necessarily indicative of the results that may be expected for the year ended April 30, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended April 30, 2001.

Recent Accounting Pronouncements

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations", which eliminates the pooling method of accounting for business combinations initiated after June 30, 2001. In addition, SFAS 141 addresses the accounting for intangible assets and goodwill acquired in a business combination. This portion of SFAS 141 is effective for business combinations completed after June 30, 2001. The Company does not expect SFAS 141 will have a material impact on the Company's financial position or results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Intangible Assets", which revises the accounting for purchased goodwill and intangible assets. Under SFAS 142, goodwill and intangible assets with indefinite lives will no longer be amortized, but will be tested for impairment annually, and in the event of an impairment indicator. SFAS 142 is effective for fiscal years beginning after December 15, 2001, with earlier adoption permitted. The Company has adopted SFAS 142 effective May 1, 2001. Presented below is a reconciliation of reported net income (loss) and per share amounts to adjusted net income (loss) and per share amounts for the three months ended July 31, 2001 and 2000 to adjust for the amortization of intangible assets for periods prior to the adoption of SFAS 142 on May 1, 2001 (in thousands, except per share amounts). The reconciliation presents the Company's results of operations for periods prior to the adoption of SFAS 142 on a basis comparable with periods since the adoption of SFAS 142.

	Net Income (Loss)		Basic Earnings (Loss) Per Share	
	Three Months Ended July 31,		Three Months Ended July 31,	
	2001	2000	2001	2000
As reported	$ (1,727)	$ 1,403	$ (.18)	$ .14
Add back goodwill amort.	--	61	--	.01
As adjusted	$ (1,727)	$ 1,464	$ (.18)	$ .15

Reclassifications

Certain prior year amounts in the accompanying financial statements have been reclassified to conform to the fiscal 2002 presentation.

D - FINANCE RECEIVABLES

The components of finance receivables as of July 31, 2001 and April 30, 2001 are as follows:

	July 31, 2001	April 30, 2001
Finance receivables	$ 203,904,198	$ 216,818,123
Unearned finance charges	(24,432,856)	(29,563,528)
Allowance for credit losses	(35,381,216)	(36,991,295)
Purchase discounts	(437,201)	(607,176)
	$ 143,652,925	$ 149,656,124

Changes in the finance receivables allowance for credit losses for the three months ended July 31, 2001 and 2000 are as follows:

	Three Months Ended July 31, 2001	2000
Balance at beginning of period	$ 36,991,295	$ 32,290,918
Provision for credit losses	11,052,665	10,592,204
Net charge-offs	(12,662,744)	(8,256,396)
Balance at end of period	$ 35,381,216	$ 34,626,726

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E - PROPERTY AND EQUIPMENT

A summary of property and equipment as of July 31, 2001 and April 30, 2001 is as follows:

	July 31, 2001	April 30, 2001
Land and buildings	$ 6,811,701	$ 6,811,701
Furniture, fixtures and equipment	5,148,464	5,053,556
Leasehold improvements	3,092,930	2,977,018
Less accumulated depreciation and amortization	(3,040,753)	(2,655,374)
	$ 12,012,342	$ 12,186,901

For the three months ended July 31, 2001 and 2000 depreciation and amortization of property and equipment amounted to $415,133 and $317,304, respectively.

F - DEBT

A summary of debt as of July 31, 2001 and April 30, 2001 is as follows:

Revolving Credit Facilities

Borrower	Lender	Facility Amount	Interest Rate	Maturity	July
Smart Choice	Finova	$ 98 million	Prime + 2.25%	Nov 2004	$
Paaco	Finova	$ 62 million	Prime + 2.00%	Nov 2004	
					$

Other Borrowings

Borrower	Lender	Facility Amount	Interest Rate	Maturity	July
Smart Choice	Huntington	N/A	Prime + .75%	Oct 2001	$
Smart Choice	High Capital et al	N/A	10.0%	Nov 2001	
Smart Choice	Individuals	N/A	Various	Various	

Smart Choice	Leasing companies	N/A	Various	Various
Paaco	Crown Group	N/A	8.50%	Mar 2002
Paaco	Individual	N/A	9.50%	May 2002
Paaco	Washington Mutual	N/A	8.50%	May 2003
Paaco	Heller Financial	N/A	Prime + 2.25%	Dec 2015
Various	Various	N/A	Various	Various

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At July 31, 2001 Smart Choice was in violation and, as a result of Smart Choice's violation, Paaco may be in violation, of certain terms of their revolving credit facilities with Finova (see Note B).

The Company's revolving credit facilities are primarily collateralized by finance receivables and inventory. Other borrowings are primarily collateralized by equipment and real estate. Interest is payable monthly or quarterly on all of the Company's debt. The loan agreements relating to certain of the above described debt contain various reporting and performance covenants including (i) maintenance of certain financial ratios and tests, (ii) limitations on borrowings from other sources, (iii) restrictions on certain operating activities, and (iv) restrictions on the payment of dividends. Typically, the amount available to be drawn under each of the Company's revolving credit facilities is a function of the underlying collateral assets (finance receivables and inventory) multiplied by a specified advance rate. However, as a result of Smart Choice's event of default, Smart Choice is currently not entitled to receive additional advances under its credit facility, and Paaco may not be entitled to receive additional advances under its credit facility.

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G - EARNINGS PER SHARE

A summary reconciliation of basic earnings per share to diluted earnings per share for the three months ended July 31, 2001 and 2000 is as follows:

	Three Months Ended July 31, 2001	Three Months Ended July 31, 2000
Net income (loss)	$ (1,727,373)	$ 1,402,774
Average shares outstanding-basic	9,762,270	9,792,149
Dilutive options	--	--

Average shares outstanding-diluted	9,762,270	9,792,149
Earnings (loss) per share:		
Basic	$ (.18)	$ .14
Diluted	$ (.18)	$ .14
Antidilutive securities not included:		
Options and warrants	426,021	225,052

H - COMMITMENTS AND CONTINGENCIES

Smart Choice Class Action Lawsuit

In March 1999, prior to Crown's ownership interest in Smart Choice, certain shareholders of Smart Choice filed two putative class action lawsuits against Smart Choice and certain of Smart Choice's officers and directors in the United States District Court for the Middle District of Florida (collectively, the "Securities Actions"). The Securities Actions purport to be brought by plaintiffs in their individual capacity and on behalf of the class of persons who purchased or otherwise acquired Smart Choice publicly traded securities between April 15, 1998 and February 26, 1999. These lawsuits were filed following Smart Choice's announcement on February 26, 1999 that a preliminary determination had been reached that the net income it had announced on February 10, 1999 for the fiscal year ended December 31, 1998 was likely overstated in a material, undetermined amount. Each of the complaints assert claims for violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission as well as a claim for the violation of Section 20(a) of the Exchange Act. The plaintiffs allege that the defendants prepared and issued deceptive and materially false and misleading statements to the public, which caused the plaintiffs to purchase Smart Choice securities at artificially inflated prices. In April 2001 Smart Choice and the plaintiffs' representatives executed an agreement whereby Smart Choice will pay $2.5 million in full settlement of the above described actions. All of the $2.5 million settlement amount has been funded by Smart Choice's insurance carrier. The agreement is subject to final approval of the court.

Other Litigation

In the ordinary course of business, the Company has become a defendant in various other types of legal proceedings. Although the Company cannot determine at this time the amount of the ultimate exposure from these ordinary course of business lawsuits, if any, management, based on the advice of counsel, does not expect the final outcome of any of these actions, individually or in the aggregate, to have a material adverse effect on the Company's financial position, results of operations or cash flows.

I - SUPPLEMENTAL CASH FLOW INFORMATION

Supplemental cash flow disclosures for the three months ended July 31, 2001 and 2000 are as follows:

Three Months Ended
July 31,

	2001	2000
Interest paid	$ 3,787,779	$ 4,029,732
Income taxes paid	27,500	2,070,000

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J - BUSINESS SEGMENTS

Operating results and other financial data are presented for the two business segments (Smart Choice and Paaco) of the Company for the three months ended July 31, 2001 and 2000. These segments are categorized by legal entity and geographical location, which is how management organizes the segments for making operating decisions and assessing performance. Each of Smart Choice and Paaco sell and finance used vehicles. Smart Choice operates in the central region of Florida and Paaco operates in major metropolitan areas in Texas (principally in the cities of Dallas and Houston). The Company's business segment data is as follows (in thousands):

	Three Months Ended July 31, 2001			Three Mont
	Paaco	Smart Choice	Consol	Paaco
Revenues:				
Sales and other	$ 25,367	$ 11,506	$ 36,873	$ 25,096
Interest income	4,748	4,899	9,647	3,827
Total	30,115	16,405	46,520	28,923
Costs and expenses:				
Cost of sales	16,272	6,908	23,180	15,437
Selling, gen. and admin.	6,728	4,050	10,778	5,275
Prov. for credit losses	3,820	7,232	11,052	4,748
Interest expense	1,502	2,198	3,700	1,735
Depreciation and amort.	202	213	415	126
Total	28,524	20,601	49,125	27,321
Income (loss) before taxes	$ 1,591	$ (4,196)	$ (2,605)	$ 1,602
Capital expenditures	$ 109	$ 161	$ 270	$ 525
Total assets	$ 91,081	$ 95,343	$ 186,424	$ 84,622

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

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

FORWARD-LOOKING INFORMATION

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for certain forward-looking statements. Certain information included in this Quarterly Report on Form 10-Q contains, and other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company or its management) contain or will contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and Section 27A of the Securities Act of 1933, as amended. The words "believe," "expect," "anticipate," "estimate," "project" and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. The Company undertakes no obligation to publicly update or revise any forward-looking statements. Such forward-looking statements are based upon management's current plans or expectations and are subject to a number of uncertainties and risks that could significantly affect current plans, anticipated actions and the Company's future financial condition and results. As a consequence, actual results may differ materially from those expressed in any forward-looking statements made by or on behalf of the Company as a result of various factors. Uncertainties and risks related to such forward-looking statements include, but are not limited to, those relating to the development of the Company's business, continued availability of lines of credit for the Company's business, changes in interest rates, competition, dependence on existing management, economic conditions (particularly in the states of Florida and Texas), changes in tax laws or the administration of such laws and changes in lending laws or regulations. Any forward-looking statements are made pursuant to the Private Securities Litigation Reform Act of 1995 and, as such, speak only as of the date made.

RESULTS OF OPERATIONS

Smart Choice Automotive Group, Inc. ("Smart Choice") and collectively with all of its subsidiaries (the "Company") is in the business of selling and financing used automobiles and trucks principally to consumers with limited or damaged credit histories. References to Smart Choice typically include Smart Choice Automotive Group, Inc. and its Florida based automotive and finance subsidiaries. Smart Choice also owns 100% of the outstanding common stock Paaco Automotive Group, Inc. ("Paaco"). As of July 31, 2001 Smart Choice operated 10 used car dealerships in central Florida while Paaco operated 12 used car dealerships in Texas (principally in the cities of Dallas and Houston).

Operating results and other financial data are presented for the two business segments of the Company (Smart Choice and Paaco) for the three months ended July 31, 2001 and 2000. These segments are categorized by legal entity and geographical location, which is how management organizes the segments for making operating decisions and assessing performance. The Company's business segment data is as follows:

CONSOLIDATED
(In Thousands)

	Revenues		Pretax Income (Loss)	
	Three Months Ended July 31,		Three Months Ended July 31,	
	2001	2000	2001	2000
Smart Choice	$ 16,405	$ 24,470	$ (4,196)	$ 630
Paaco	30,115	28,923	1,591	1,602
Consolidated	$ 46,520	$ 53,393	$ (2,605)	$ 2,232

THREE MONTHS ENDED JULY 31, 2001 VS. THREE MONTHS ENDED JULY 31, 2000

Revenues decreased $6.9 million, or 12.9%, for the three months ended July 31, 2001 compared to the same period in the prior fiscal year. The decrease was principally the result of (i) a decrease in revenues at Smart Choice ($8.1 million) resulting from a 25% decrease in the number of vehicles sold and a 20% decrease in the average retail sales price per unit, partially offset by (ii) higher revenues at Paaco ($1.2 million) resulting from higher interest income. The Company reported a pretax loss of $2.6 million for the three months ended July 31, 2001 as compared to $2.2 million pretax income for the same period in the prior fiscal year. The $4.8 million decrease is the result of (i) Smart Choice's provision for credit losses increasing to $7.2 million in the current fiscal period from $5.8 million in the same period in the prior fiscal year ($1.4 million), (ii) cost of sales increasing to 60.0% of sales and other in the current fiscal period from 56.8% in the same period in the prior fiscal year ($.4 million), and (iii) a 33% decrease in revenues without a corresponding decrease in costs and expenses.

PAACO
(Dollars in Thousands)

	% Change	As a % of Sal

	Three Months Ended July 31, 2001	Three Months Ended July 31, 2000	2001 vs 2000	Three Mont[hs Ended] July [31,] 2001
Revenues:				
Sales and other	$ 25,367	$ 25,096	1.1%	100.0%
Interest income	4,748	3,827	24.1	18.7
Total	30,115	28,923	4.1	118.7
Costs and expenses:				
Cost of sales	16,272	15,437	5.4	64.1
Selling, gen and admin	6,728	5,275	27.5	26.5
Prov for credit losses	3,820	4,748	(19.5)	15.1
Interest expense	1,502	1,735	(13.4)	5.9
Depreciation and amort	202	126	60.3	.8
Total	28,524	27,321	4.4	112.4
Pretax income	$ 1,591	$ 1,602	(.7)	6.3

THREE MONTHS ENDED JULY 31, 2001 VS. THREE MONTHS ENDED JULY 31, 2000

Revenues increased $1.2 million, or 4.1%, for the three months ended July 31, 2001 as compared to the same period in the prior fiscal year. The increase was principally the result of higher interest income resulting from (i) a 14.4% increase in the average finance receivables balances outstanding, and (ii) a slight increase in the average interest rate charged on Paaco's installment loans. Pretax income was virtually unchanged during the two periods as costs and expenses increased substantially the same amount ($1.2 million) as the increase in revenues.

SMART CHOICE
(Dollars in Thousands)

	Three Months Ended July 31, 2001	Three Months Ended July 31, 2000	% Change 2001 vs 2000	As a % of Sa[les] Three Mon[ths Ended] July [31,] 2001
Revenues:				
Sales and other	$ 11,506	$ 18,924	(39.2)%	100.0%
Interest income	4,899	5,546	(11.7)	42.6
Total	16,405	24,470	(33.0)	142.6
Costs and expenses:				

Cost of sales	6,908	10,751	(35.7)	60.0
Selling, gen and admin	4,050	4,529	(10.6)	35.2
Prov for credit losses	7,232	5,844	(23.8)	62.9
Interest expense	2,198	2,463	(10.8)	19.1
Depreciation and amort	213	253	(15.8)	1.9
Total	20,601	23,840	(13.6)	179.1
Pretax income	$ (4,196)	$ 630	NM	(36.5)

NM - Not meaningful

THREE MONTHS ENDED JULY 31, 2001 VS. THREE MONTHS ENDED JULY 31, 2000

Revenues decreased $8.1 million, or 33.0%, for the three months ended July 31, 2001 as compared to the same period in the prior fiscal year. The decrease was principally the result of (i) a 25% decrease in the number of vehicles sold, and (ii) a 20% decrease in the average sales price per retail vehicle sold. Beginning in March 2001 Smart Choice changed its underwriting practices in an effort to reduce credit losses. The changes in its underwriting practices resulted in fewer individuals being approved for credit, which resulted in a lower number of vehicles sold. In addition, Smart Choice also reduced the average retail sales price per unit by 20% during the current fiscal period. Smart Choice believes that by selling a lower priced vehicle and financing it over a shorter term, its credit losses will decline.

Smart Choice reported a pretax loss of $4.2 million for the three months ended July 31, 2001 as compared to $.6 million pretax income for the same period in the prior fiscal year. The $4.8 million decrease is principally the result of (i) the provision for credit losses increasing to $7.2 million in the current fiscal period from $5.8 million in the same period in the prior fiscal year ($1.4 million), (ii) cost of sales increasing to 60.0% of sales and other in the current fiscal period from 56.8% in the same period in the prior fiscal year ($.4 million), and (iii) a 33% decrease in revenues without a corresponding decrease in costs and expenses. Smart Choice believes that changes in the structure of its installment sales contracts and inventory mix beginning in May 2000 and continuing into February 2001 may have contributed to the increase in credit losses during the three months ended July 31, 2001. In particular, during this period Smart Choice sold a higher priced vehicle and shortened the term of its installment sales contracts. These actions increased the average monthly payment on its contracts to a level which may have made it difficult for certain customers to remain current in their payments. Many of the accounts charged-off and vehicles repossessed during the three months ended July 31, 2001 pertain to loans originated between May 2000 and February 2001. In March 2001 Smart Choice began selling lower priced vehicles and reduced the average interest rate charged on its loans which has decreased the average monthly payment required on its contracts. Smart Choice believes that by making its monthly payments more affordable, its credit losses will decline.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities was $1.0 million for the three months ended July 31, 2001 as compared to a $7.3 million use of cash for the same period in the prior fiscal year. The $8.3 million increase was principally the result of (i) the net finance receivables portfolio increasing by $6.1 million in the prior fiscal period as compared to a decrease of $6.0 million in the current fiscal period, partially offset by (ii) a $3.1 million decrease in net income. Net cash used in investing activities was $.3 million for the three months ended July 31, 2001 as compared to $.9 million in the same period in the prior fiscal year. The $.6 million decrease was principally the result of a decrease in the purchase of property and equipment. Net cash used by financing activities was $.3 million for the three months ended July 31, 2001 as compared to a $7.5 million source of cash for the same period in the prior fiscal year. The $7.8 million decrease was principally the result of the prior period including an increase in borrowings from revolving credit facilities of $8.2 million.

PAACO

Paaco's sources of liquidity principally include cash on hand ($.7 million at July 31, 2001) and cash generated from operations. In addition, Paaco has a $62 million revolving credit facility with Finova, of which $59.0 million was outstanding at July 31, 2001. However, as of July 31, 2001, Smart Choice's revolving credit facility with Finova was in default, and there is a question as to whether such default is a basis for an event of default under Paaco's revolving credit facility (see Smart Choice discussion below). Accordingly, there is uncertainty as to whether Paaco is eligible to draw any additional monies under its revolving credit facility. Paaco's revolving credit facility matures in November 2004.

It is unlikely that Finova will increase the size of Paaco's credit facility, or that Paaco could refinance such facility with a new lender since Paaco's advance rate (ie. 70% of eligible receivables and inventory) is believed to be above market. Accordingly, for the foreseeable future, Paaco's ability to expand its operations may be limited as a result of a shortage of additional capital. Consequently, Paaco anticipates operating its business at sales and asset levels consistent with its recent past, and not substantially expanding its operations.

SMART CHOICE

For the three months ended July 31, 2001 Smart Choice (excluding Paaco) reported a net loss of $2.7 million. Smart Choice has a $98 million revolving credit facility with Finova, of which $88.4 million was outstanding as of July 31, 2001. Since December 2000 Smart Choice has been over-advanced on its revolving credit facility, which constitutes an event of default under the facility. As of July 31, 2001 Smart Choice was over-advanced by $20.9 million. Absent funding from an outside source, Smart Choice does not expect it will be able to come into compliance with the current advance rate provisions of its credit facility. As a result of the event of default, Smart Choice is currently not entitled to receive additional advances under its credit facility. Smart Choice is presently operating its business from the cash generated from the collection of its finance receivables and down payments received in connection with the sale of vehicles.

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Since January 2001 Smart Choice has been in discussions with Finova with regard to possible solutions to the over-advanced position. There are several possible outcomes that may result from these negotiations, including:

(i) a restructuring of the Smart Choice credit facility which brings Smart Choice back into compliance;

(ii) a sale of substantially all of Smart Choice's assets with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate;

(iii) an agreement among Smart Choice, Paaco and Finova whereby substantially all of the assets and liabilities of Smart Choice are liquidated with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate; or

(iv) Finova's exercise of its rights under the credit facility and acceleration of the maturity of the loan seeking to liquidate or sell the collateral, which action may prompt Smart Choice to take actions to protect the interests of its shareholders, including the filing of a plan of reorganization under federal bankruptcy laws.

Although management is exploring a number of alternatives, including those listed above, the Company cannot predict how or whether Smart Choice's default will be resolved. The opinion of the Company's independent certified public accountants covering the fiscal year ended April 30, 2001 expressed substantial doubt about the Company's ability to continue as a going concern. The consolidated financial statements for the three months ended July 31, 2001 do not include any adjustments relating to the recoverability of recorded asset amounts that might be necessary should the Company be unable to continue in existence.

RECENT ACCOUNTING PRONOUNCEMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141 ("SFAS 141"), "Business Combinations", which eliminates the pooling method of accounting for business combinations initiated after June 30, 2001. In addition, SFAS 141 addresses the accounting for intangible assets and goodwill acquired in a business combination. This portion of SFAS 141 is effective for business combinations completed after June 30, 2001. The Company does not expect SFAS 141 will have a material impact on the Company's financial position or results of operations.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 142 ("SFAS 142"), "Goodwill and Intangible Assets", which revises the accounting for purchased goodwill and intangible assets. Under SFAS 142, goodwill and intangible assets with indefinite lives will no longer be amortized, but will be tested for impairment annually, and in the event of an impairment indicator. SFAS 142 is effective for fiscal years beginning after December 15, 2001, with earlier adoption permitted. The Company has adopted SFAS

142 effective May 1, 2001.

SEASONALITY

The Company's automobile sales and finance business is seasonal in nature. In such business, the Company's third fiscal quarter (November through January) is historically the slowest period for car and truck sales. Many of the Company's operating expenses such as administrative personnel, rent and insurance are fixed and cannot be reduced during periods of decreased sales. Conversely, the Company's fourth fiscal quarter (February through April) is historically the busiest time for car and truck sales as many of the Company's customers use income tax refunds as a down payment on the purchase of a vehicle. None of the Company's other businesses experience significant seasonal fluctuations.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk on its financial instruments from changes in interest rates. The Company does not use financial instruments for trading purposes or to manage interest rate risk. The Company's earnings are impacted by its net interest income, which is the difference between the income earned on interest-bearing assets and the interest paid on interest bearing notes payable. Increases in market interest rates could have an adverse effect on profitability. Financial instruments consist of fixed rate finance receivables and fixed and variable rate notes payable. The Company's finance receivables generally bear interest at fixed rates ranging from 12% to 26%. These finance receivables have remaining maturities from one to 42 months. At July 31, 2001 the majority of the Company's notes payable contained variable interest rates that fluctuate with market rates. Therefore, an increase in market interest rates would decrease the Company's net interest income and profitability.

The table below illustrates the impact which hypothetical changes in market interest rates could have on the Company's pretax earnings. The calculations assume (i) the increase or decrease in market interest rates remain in effect for twelve months, (ii) the amount of variable rate notes payable outstanding during the period decreases in direct proportion to decreases in finance receivables as a result of scheduled payments and anticipated charge-offs, and (iii) there is no change in prepayment rates as a result of the interest rate changes.

Change in Interest Rates	Change in Pretax Earnings (in thousands)
+2%	$ (2,074)
+1%	(1,037)

-1%	1,037
-2%	2,074

PART II

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Each of Paaco and Smart Choice have revolving credit facilities with Finova. Since December 2000 Smart Choice has been over-advanced on its revolving credit facility, which constitutes an event of default under the facility. As of July 31, 2001 Smart Choice was over-advanced by $20.9 million. Absent funding from an outside source, Smart Choice does not expect it will be able to come into compliance with the current advance rate provisions of its credit facility. There is uncertainty as to whether Smart Choice's event of default is the basis for an event of default under Paaco's revolving credit facility. In any event, Paaco is a wholly-owned subsidiary of Smart Choice, and ultimately Paaco could be affected by the default of Smart Choice under its Finova credit facility. As a result of the event of default, Smart Choice is currently not entitled to receive additional advances under its credit facility, and Paaco may not be entitled to receive additional advances under its credit facility.

Since January 2001 Smart Choice has been in discussions with Finova with regard to possible solutions to the over-advanced position. There are several possible outcomes that may result from these negotiations, including:

(i) a restructuring of the Smart Choice credit facility which brings Smart Choice back into compliance;

(ii) a sale of substantially all of Smart Choice's assets with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate;

(iii) an agreement among Smart Choice, Paaco and Finova whereby substantially all of the assets and liabilities of Smart Choice are liquidated with the proceeds being used to pay down a portion of its credit facility, and the unpaid portion being absorbed by Finova (forgiveness of debt) and Paaco as the parties may negotiate; or

(iv) Finova's exercise of its rights under the credit facility and acceleration of the maturity of the loan seeking to liquidate or sell the collateral, which action may prompt Smart Choice to take actions to protect the interests of its shareholders, including the filing of a plan of reorganization under federal bankruptcy laws.

Although management is exploring a number of alternatives, including those listed above, the Company cannot predict how or whether Smart Choice's default will be resolved. The opinion of the Company's independent certified public accountants covering the fiscal year ended April 30, 2001 expressed substantial doubt about the Company's ability to continue as a going concern.

The consolidated financial statements for the three months ended July 31, 2001 do not include any adjustments relating to the recoverability of recorded asset amounts that might be necessary should the Company be unable to continue in existence.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

None.

(b) Reports on Form 8-K:

During the fiscal quarter ended July 31, 2001 no reports on Form 8-K were filed.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

SMART CHOICE AUTOMOTIVE GROUP, INC.

By: /s/ James Edward Ernst

James Edward Ernst
President and Chief Executive Officer
(Principal Executive Officer)

By: /s/ Larry Kiem

Larry Kiem
Controller
(Principal Financial and Accounting Officer)

Dated: September 13, 2001