PMC CAPITAL INC
Form 10-Q
May 15, 2002

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

FORM 10 Q

(Mark One)

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

For the quarterly period ended **March 31, 2002**

OR

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

For the transition period from _____ to _____.

Commission File Number 811-3780

PMC CAPITAL, INC.

(Exact name of registrant as specified in its charter)

FLORIDA	59-2338439
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
18111 Preston Road, Suite 600, Dallas, TX 75252	(972) 349-3200
(Address of principal executive offices)	(Registrant s telephone number)

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 [ ]

As of May 7, 2002, Registrant had outstanding 11,853,516 shares of Common Stock, par value $.01 per share.

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PMC CAPITAL, INC. AND SUBSIDIARIES

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PART I

Financial Information

ITEM I.

Financial Statements

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PMC CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share data)

	March 31, 2002	December 31, 2001
	(Unaudited)	
ASSETS		
Investments at value:		
Loans receivable, net	$ 107,857	$ 107,392
Retained interests in transferred assets	31,867	33,537
Cash equivalents	14,008	16,989
Assets acquired in liquidation	2,528	329
Mortgage-backed security of affiliate	1,509	1,701
Investment in unconsolidated subsidiaries	172	67
Restricted investments	46	95
Total investments at value	157,987	160,110
Other assets:		
Due from affiliates	843	607
Accrued interest receivable	630	462
Cash	252	329
Property and equipment, net	146	133
Receivable for loans sold	137	184
Deferred charges, deposits and other assets	937	873
Total other assets	2,945	2,588
Total assets	$ 160,932	$ 162,698
LIABILITIES AND SHAREHOLDERS EQUITY		
Liabilities:		
Notes and debentures payable	$ 76,310	$ 76,310
Dividends payable	1,959	2,434
Accrued interest payable	747	1,193
Accounts payable	737	753
Borrower advances	646	798
Due to affiliates	308	189
Other liabilities	596	1,113
Total liabilities	81,303	82,790
Commitments and contingencies		
Cumulative preferred stock of subsidiary	7,000	7,000
Shareholders equity:		
Common stock, authorized 30,000,000 shares of $.01 par value, 11,853,516 shares issued and outstanding at March 31, 2002 and December 31, 2001	119	119
Additional paid-in capital	71,508	71,508
Dividends in excess of earnings	(336)	(340)
Net unrealized appreciation (depreciation) on investments	1,338	1,621

	72,629	72,908
Total liabilities and shareholders equity	$ 160,932	$ 162,698
Net asset value per common share	$ 6.13	$ 6.15

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

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PMC CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)

	Three Months Ended March 31, 2002	Three Months Ended March 31, 2001
	(Unaudited)	
Investment income:		
Interest	$ 2,607	$ 3,154
Income from retained interests in transferred assets	1,147	1,265
Premium income	132	110
Other investment income, net	323	163
Total investment income	4,209	4,692
Other income, net	475	471
Equity in income of unconsolidated subsidiaries, net	101	90
Total income	4,785	5,253
Expenses:		
Interest	1,185	1,380
Salaries and related benefits	1,012	1,068
General and administrative	221	214
Legal and accounting	100	86
Rent	79	81
Profit sharing plan	38	51
Small Business Administration fees	21	32
Directors and shareholders expense	10	8
Total expenses	2,666	2,920
Net operating income	2,119	2,333
Realized and unrealized gain (loss) on investments:		
Investments written-off	(156)	(290)
Change in unrealized appreciation (depreciation) on investments	(283)	417
Total realized and unrealized gain (loss) on investments	(439)	127
Net operating income and realized and unrealized gain (loss) on investments	$ 1,680	$ 2,460
Preferred dividends	$ 62	$ 62
Basic weighted average common shares outstanding	11,854	11,853
Diluted weighted average common shares outstanding	11,854	11,857
Basic and diluted earnings per common share	$ 0.14	$ 0.20

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

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PMC CAPITAL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Three Months Ended March 31,	
	2002	2001
	(Unaudited)	
Cash flows from operating activities:		
Net operating income and realized and unrealized gain (loss) on investments	$ 1,680	$ 2,460
Adjustments to reconcile net operating income and realized and unrealized gain (loss) on investments to net cash provided by operating activities:		
Loans funded, held for sale	(2,032)	(727)
Proceeds from sale of guaranteed loans	1,703	2,264
Realized and unrealized (gain) loss on investments	439	(127)
Unrealized premium income, net		(8)
Depreciation and amortization	38	44
Accretion of loan discount and deferred fees	(12)	(27)
Equity in income of unconsolidated subsidiaries, net	(101)	(90)
Other operating assets and liabilities	(1,323)	(401)
Net cash provided by operating activities	392	3,388
Cash flows from investing activities:		
Loans funded	(9,740)	(14,901)
Principal collected and other adjustments	7,180	1,297
Proceeds from retained interests in transferred assets	1,834	385
Proceeds from mortgage-backed security of affiliate	187	11
Purchase of property and equipment and other assets	(30)	(32)
Investment in retained interests in transferred assets	(380)	
Release of (investment in) restricted cash	49	(370)
Advances (to) from affiliates, net	(116)	363
Net cash used in investing activities	(1,016)	(13,247)
Cash flows from financing activities:		
Payment of dividends on common stock	(2,371)	(2,963)
Payment of dividends on preferred stock	(63)	(63)
Net cash used in financing activities	(2,434)	(3,026)
Net decrease in cash and cash equivalents	(3,058)	(12,885)
Cash and cash equivalents, beginning of year	17,318	21,909
Cash and cash equivalents, end of period	$ 14,260	$ 9,024
Supplemental disclosures:		
Interest paid	$ 1,630	$ 1,779
Reclassification from loans receivable to assets acquired in liquidation	$ 2,318	$ 217

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

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PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Interim Financial Statements:

The accompanying consolidated balance sheet of PMC Capital, Inc. (PMC Capital) and its wholly-owned regulated investment company subsidiaries (collectively, we , us or our) as of March 31, 2002 and the consolidated statements of income and cash flows for the three months ended March 31, 2002 and 2001 have not been audited by independent accountants. In the opinion of our management, the financial statements reflect all adjustments necessary to present fairly the financial position at March 31, 2002 and the results of operations for the three months ended March 31, 2002 and 2001. These adjustments are of a normal recurring nature.

Certain notes and other information have been omitted from the interim financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended December 31, 2001.

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and (ii) the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Our most sensitive estimates involve valuing and recording income on our retained interests in transferred assets and in determining loan loss reserves for loans receivable.

The results for the three months ended March 31, 2002 are not necessarily indicative of future financial results.

Note 2. Business and Consolidation:

Business

PMC Capital is a diversified closed-end management investment company that operates as a business development company (BDC) under the Investment Company Act of 1940, as amended (the 1940 Act). Our common stock (the Common Stock) is traded on the American Stock Exchange under the symbol PMC.

We are engaged in the business of originating loans to small businesses either directly or through our three principal subsidiaries: First Western SBLC, Inc. (First Western), PMC Investment Corporation (PMCIC) and Western Financial Capital Corporation (Western Financial).

First Western, PMCIC and Western Financial are registered under the 1940 Act as diversified closed-end management investment companies. In addition, PMC Capital is either directly or indirectly the sole shareholder or partner of several non-investment company act subsidiaries. These are: PMC Advisers, Ltd. and its subsidiary (PMC Advisers); PMC Funding Corp. and its subsidiary (PMC Funding); PMC Capital, L.P. 1998-1 (the 1998 Partnership) and PMC Capital, L.P. 1999-1 (the 1999 Partnership).

In addition, at March 31, 2002, PMC Capital owned approximately 33.4% of PMC Joint Venture, L.P. 2000 (the 2000 Joint Venture) and 60.8% of PMC Joint Venture, L.P. 2001 (the 2001 Joint Venture , and together with the 1998 Partnership, the 1999 Partnership and the 2000 Joint Venture, the SPEs). PMC Commercial Trust (PMC Commercial), our affiliate through common management, owns the remaining interests in the 2001 Joint Venture and the 2000 Joint Venture.

Consolidation

The consolidated financial statements include the accounts of PMC Capital and its wholly-owned regulated investment company subsidiaries, First Western, PMCIC and Western Financial. All material intercompany balances and transactions have been eliminated.

PMC Advisers, which acts as the investment adviser for PMC Commercial, and PMC Funding, which holds assets on our behalf, are accounted for using the equity method of accounting in conformity with Federal securities laws. Our ownership interests in SPEs created in conjunction with structured loan transactions are accounted for as retained interests in transferred assets (Retained Interests) in accordance with Statement of

PMC CAPITAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Financial Accounting Standards (SFAS) No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities (SFAS No. 140) in our consolidated financial statements.

Note 3. Retained Interests in Transferred Assets:

In our structured loan sale transactions, we contributed loans receivable to an SPE in exchange for an ownership interest in that entity. The SPE issued notes payable (the Structured Notes) (usually through a private placement) to third parties (Noteholders). The SPE then distributed a portion of the Structured Notes proceeds to us. The Structured Notes are collateralized solely by the assets of the SPE which means that should the SPE fail to make payments on the Structured Notes, the Noteholders have no recourse to us. Upon the completion of our structured loan sale transactions, we recorded the transfer of loans receivable as a sale. As a result, neither the loans receivable contributed to the SPE, the Structured Notes issued by the SPE, nor the operating results of the SPE are included in our consolidated financial statements. The difference between (i) the carrying value of the loans receivable sold and (ii) the sum of (a) cash received and (b) the present value of the future cash flows from the Retained Interests, constituted the gain or loss on sale. Retained Interests are carried at estimated fair value, with realized and unrealized gains and losses included in the consolidated statements of income.

Information pertaining to our structured loan sale transactions as of March 31, 2002 is as follows:

	1998 Partnership	1999 Partnership	2000 Joint Venture (1)	2001 Joint Venture (1)
	(Dollars in thousands)			
Principal outstanding on sold loans	$28,546	$45,938	$26,455	$47,419
Structured Notes balance outstanding	$27,117	$43,004	$23,599	$43,566
Cash in the collection account	$ 374	$ 1,320	$ 268	$ 503
Cash in the reserve account	$ 2,298	$ 2,808	$ 1,593	$ 2,854
Weighted average interest rate on loans	Prime + 1.20%	9.45%	9.32%	9.74%
Discount rate assumptions(2)	4.8% to 13.1%	8.6% to 13.3%	8.7% to 13.4%	8.4% to 13.1%
Prepayment rate assumption(3)	11.0%	8.0%	8.0%	9.0%
Weighted average remaining life of loans(4)	3.89 years	4.15 years	4.69 years	5.34 years
Aggregate losses assumed(5)	2.37%	2.20%	2.26%	2.98%
Aggregate losses to date	%	%	%	%

(1) Balances represent PMC Capital s share of the respective joint venture.

(2) Discount rates are based upon our estimate of comparable rates which would be used by potential purchasers of similar assets. As there is no quoted market value for our Retained Interests, changes in the general interest rate environment do not necessarily affect our discount rates. As of March 31, 2002, the discount rates were (i) 4.8% to 8.7% for our required overcollateralization, (ii) 10.1% to 10.4% for our reserve funds and (iii) 13.1% to 13.4% for our interest-only strip receivables.

(3) The prepayment rate is based on the performance of the loan pools, adjusted for anticipated principal payments considering the current loan pools and similar loans.

(4) The weighted average life is calculated by summing the product of (i) the sum of the principal collections expected in each future period multiplied by (ii) the number of periods until collection, and then dividing that total by (iii) the remaining principal balance.

(5) Represents aggregate estimated losses as a percentage of the principal outstanding based upon per annum estimated losses ranging from 0.3% to 0.8%, plus current reserves.

The value of our Retained Interests is based on our estimate of the discounted future cash flows we will receive. In determining the present value of expected future cash flows, we make estimates in determining (i) the timing of those cash flows and (ii) the discount rates. The amount and timing of cash flows is generally determined based on our estimates of loan losses and anticipated prepayment speeds relating to the loans receivable contributed to the SPE. Actual loan losses and prepayments may vary significantly from our assumptions. The discount rates that we utilize in computing the net present value of future cash flows are based upon our estimate

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of the inherent risks associated with each cash flow stream. Due to the limited number of entities that conduct similar transactions, the relatively small size of our Retained Interests and the limited number of buyers for such assets, no quoted market value exists. Therefore, our estimate of the fair value may vary significantly from what a willing buyer would pay for these assets.

The components of our Retained Interests are as follows:

(1) Our required overcollateralization which consists of the cash flows associated with the portion of the principal and interest collected by the SPE from the subordinated portion of the loans receivable sold (the OC Piece). The OC Piece represents the excess of the loans receivable contributed to the SPE over the notes payable issued by the SPE and serves as additional collateral for the Noteholders.

(2) The Reserve Fund and the interest earned thereon. The Reserve Fund represents cash that is required to be kept in a liquid cash account by the SPE as collateral for the Noteholders, a portion of which was contributed by us to the SPE upon formation, and a portion of which is built up over time by the SPE from the cash flows of the underlying loans receivable.

(3) The interest-only strip receivable (the IO Receivable). The IO Receivable is comprised of the cash flows that will be received by us in the future after payment by the SPE of (a) all interest and principal due to the Noteholders, (b) all principal and interest on the OC Piece, (c) any required funding of the Reserve Fund and (d) on-going costs of the transaction.

Our Retained Interests are comprised of the following:

	March 31, 2002			
	Total	**OC Piece**	**Reserve Fund**	**IO Receivable**
	(In thousands)			
First Western	$ 2,991	$	$ 809	$ 2,182
1998 Partnership	4,450	1,660	1,749	1,041
1999 Partnership	8,975	3,986	2,169	2,820
2000 Joint Venture	5,150	3,028	1,214	908
2001 Joint Venture	10,301	4,375	2,152	3,774
	$31,867	$13,049	$8,093	$10,725

	December 31, 2001			
	Total	**OC Piece**	**Reserve Fund**	**IO Receivable**
	(In thousands)			
First Western	$ 2,981	$	$ 743	$ 2,238
1998 Partnership	5,069	1,871	2,048	1,150
1999 Partnership	10,018	4,428	2,441	3,149
2000 Joint Venture	5,310	3,083	1,238	989
2001 Joint Venture	10,159	4,397	1,825	3,937
	$33,537	$13,779	$8,295	$11,463

In determining the fair value of our Retained Interests related to First Western for our SBA 7(a) transactions, our assumptions at March 31, 2002 included a prepayment speed ranging from 20% to 30% per annum, a loss rate ranging from 0.4% to 0.7% per annum and discount rates ranging from 7.0% to 13.4%.

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The following is a sensitivity analysis of our Retained Interests to highlight the volatility that results when prepayments, losses and discount rates are different than our assumptions. The following summarizes the results of the sensitivity analysis as of March 31, 2002:

Changed Assumption	Pro-Forma Value	Asset Reduction
Losses increase by 50 basis points per annum (1)	$29,534,000	$2,333,000
Losses increase by 100 basis points per annum (1)	$27,269,000	$4,598,000
Rate of prepayment increases by 5% per annum (2)	$30,667,000	$1,200,000
Rate of prepayment increases by 10% per annum (2)	$29,758,000	$2,109,000
Discount rates increase by 100 basis points	$30,645,000	$1,222,000
Discount rates increase by 200 basis points	$29,501,000	$2,366,000

(1) *If we experience losses in excess of anticipated losses, the effect on our Retained Interests would first reduce the value of the IO Receivables. To the extent the IO Receivables could not fully absorb the losses, the effect would then be to reduce the value of our Reserve Funds and then the value of our OC Pieces.*

(2) *For example, an 8% assumed rate of prepayment would be increased to 13% or 18% based on increases of 5% or 10% per annum, respectively.*

These sensitivities are hypothetical and should be used with caution. Pro-forma values based on changes in these assumptions generally cannot be extrapolated since the relationship of the change in assumption to the change in fair value may not be linear. The effect of a variation in a particular assumption on the fair value of our Retained Interests is calculated without changing any other assumption. In reality, changes in one factor are not isolated from changes in another which might magnify or counteract the sensitivities.

The following information summarizes the financial position of the SPEs at March 31, 2002 and December 31, 2001. We own 100% of the 1998 Partnership and the 1999 Partnership. At March 31, 2002, we owned 33.4% of the 2000 Joint Venture and 60.8% of the 2001 Joint Venture. At December 31, 2001 we owned 33.3% of the 2000 Joint Venture and 59.5% of the 2001 Joint Venture. Balances for the 2000 Joint Venture and the 2001 Joint Venture represent 100% of the limited partnership interests.

Summary of Financial Position:

	1998 Partnership		1999 Partnership		2000 Joint Venture		2001 Joint Venture	
	March 31, 2002	December 31, 2001	March 31, 2002	December 31, 2001	March 31, 2002	December 31, 2001	March 31, 2002	December 31, 2001
	(In millions)							
Loans Receivable, Net	$ 28.4	$ 29.8	$ 45.9	$ 47.9	$ 78.8	$ 79.7	$ 76.8	$ 78.2
Total Assets	$ 31.2	$ 35.4	$ 50.3	$ 55.7	$ 84.8	$ 85.7	$ 82.6	$ 83.6
Notes Payable	$ 27.1	$ 30.7	$ 43.0	$ 47.6	$ 70.3	$ 71.1	$ 70.4	$ 71.8
Total Liabilities	$ 27.2	$ 30.8	$ 43.2	$ 47.8	$ 70.5	$ 71.3	$ 70.6	$ 72.0
Partners Capital	$ 4.0	$ 4.6	$ 7.1	$ 7.9	$ 14.3	$ 14.4	$ 12.0	$ 11.6

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The following information summarizes the results of operations of our SPEs for the three months ended March 31, 2002 and 2001. Amounts represent 100% of the limited partnership interests for the 2000 Joint Venture and the 2001 Joint Venture.

Summary of Operations:

	1998 Partnership		1999 Partnership		2000 Joint Venture		2001 Joint Venture
	2002	2001	2002	2001	2002	2001	2002 (1)
	(In thousands)						
Interest Income	$ 470	$ 960	$ 1,085	$ 1,375	$ 1,776	$ 2,028	$ 1,879
Total Revenues	$ 494	$ 1,019	$ 1,175	$ 1,416	$ 1,880	$ 2,185	$ 1,917
Interest Expense	$ 266	$ 704	$ 724	$ 838	$ 1,287	$ 1,345	$ 1,135
Total Expenses	$ 317	$ 734	$ 833	$ 884	$ 1,351	$ 1,399	$ 1,198
Net Income	$ 177	$ 285	$ 342	$ 532	$ 529	$ 786	$ 719

(1) *There were no operations prior to June 27, 2001.*

Our limited partnership allocation of the assets, liabilities and partners capital of the 2000 Joint Venture as of March 31, 2002 was $28.4 million, $23.7 million and $4.7 million, respectively. Our limited partnership allocation of the assets, liabilities and partners capital of the 2000 Joint Venture as of December 31, 2001 was $28.6 million, $23.8 million and $4.8 million, respectively. Our limited partnership allocation of the assets, liabilities and partners capital of the 2001 Joint Venture as of March 31, 2002 was $51.0 million, $43.7 million and $7.3 million, respectively. Our limited partnership allocation of the assets, liabilities and partners capital of the 2001 Joint Venture as of December 31, 2001 was $51.9 million, $45.0 million and $6.9 million, respectively.

Our limited partnership allocation of the net income of the 2000 Joint Venture for the periods ended March 31, 2002 and 2001 was approximately $39,000 and $170,000, respectively. The decrease is due to two impaired loans on which we have discontinued the accrual of interest. Our limited partnership allocation of the net income of the 2001 Joint Venture for the period ended March 31, 2002 was approximately $437,000.

In accordance with SFAS No. 140, our consolidated financial statements do not include our SPE assets, liabilities, partners capital, revenues or expenses. As a result, at March 31, 2002 and December 31, 2001 our consolidated balance sheets do not include the $160.9 million and $171.6 million of assets, respectively, and $137.8 million and $147.4 million of liabilities, respectively, related to our structured loan sale transactions recorded by our SPEs. Our Retained Interests related to these structured loan sale transactions were $28.9 million and $30.6 million at March 31, 2002 and December 31, 2001, respectively.

Our ownership of the 2001 Joint Venture and the 2000 Joint Venture is based on our share of the capital of the joint ventures, respectively. Our share of the cash flows from the 2001 Joint Venture and the 2000 Joint Venture is based upon the remaining principal balance of the underlying loans receivable contributed by us to the 2001 Joint Venture and the 2000 Joint Venture.

The income from our Retained Interests is comprised of the yield earned on our Retained Interests. The yield earned is determined based on our estimates of future cash flows. We update our cash flow assumptions on a quarterly basis and any changes to cash flow assumptions will affect the yield on our Retained Interests. For the three months ended March 31, 2002 and 2001, the annualized yield on our Retained Interests was 12.7% and 14.7%, respectively. For the year ended December 31, 2001, the yield on our Retained Interests was 14.9%.

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We are the servicer for all loans held by the SPEs. Servicing fee income for the three months ended March 31, 2002 and 2001 for the SPEs was approximately $117,000 and $118,000, respectively, and is included in other income in our consolidated statements of income. We have not established a servicing asset or liability as our servicing fees are considered adequate compensation.

We received approximately $3.0 million and $1.7 million in cash distributions from our SPEs during the three months ended March 31, 2002 and 2001, respectively.

Note 4. Assets Acquired in Liquidation:

At March 31, 2002 and December 31, 2001, the aggregate value of our assets acquired in liquidation, as reduced for anticipated selling costs, was estimated to be approximately $2,528,000 and $329,000, respectively. Included in assets acquired in liquidation at March 31, 2002 are two limited service hospitality properties acquired through foreclosure during the first quarter of 2002. We are currently marketing and negotiating to sell our assets acquired in liquidation.

Note 5. Net Unrealized Appreciation (Depreciation) on Investments and Realized and Unrealized Gain (Loss) on Investments:

Net unrealized appreciation (depreciation) on investments is comprised of the following:

	March 31, 2002	December 31, 2001
	(In thousands)	
Loans receivable	$ (409)	$ (443)
Retained interests in transferred assets	1,751	1,985
Mortgage-backed security of affiliate	74	79
Assets acquired in liquidation	(74)	
Net unrealized appreciation (depreciation) on investments	$1,342	$ 1,621

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Realized and unrealized gain (loss) on investments were as follows:

	Three Months Ended March 31, 2002		
	Retained Interests in Transferred Assets/Other Investments	Loans Receivable	Total
Investments written-off	$	$ (156,000)	$ (156,000)
Change in unrealized appreciation (depreciation) on investments	(317,000)	34,000	(283,000)
Total realized and unrealized loss on investments	$ (317,000)	$ (122,000)	$ (439,000)

	Three Months Ended March 31, 2001		
	Retained Interests in Transferred Assets/Other Investments	Loans Receivable	Total
Investments written-off	$	$ (290,000)	$ (290,000)
Change in unrealized appreciation (depreciation) on investments	175,000	242,000	417,000
Total realized and unrealized gain (loss) on investments	$ 175,000	$ (48,000)	$ 127,000

Note 6. Earnings Per Common Share Computations:

The computations of basic earnings per common share are based on our weighted average shares outstanding. The weighted average shares outstanding were 11,854,000 and 11,853,000 for the three months ended March 31, 2002 and 2001, respectively. The fully diluted weighted average shares outstanding were 11,857,000 during the three months ended March 31, 2001. There was no change in the weighted average shares outstanding for the effect of stock options during the three months ended March 31, 2002 since the stock options were anti-dilutive.

Earnings are defined as net operating income and realized and unrealized gain (loss) on investments and are reduced by the preferred stock dividend requirements of PMCIC.

Note 7. Dividends Paid and Declared:

During December 2001, we declared a $0.20 per share dividend to common shareholders of record on December 31, 2001, which was paid during January 2002. On March 18, 2002, our Board of Directors declared a dividend of $0.16 per share to common shareholders of record on March 28, 2002, which was paid on April 8, 2002.

Note 8. Commitments and Contingencies:

Loan commitments and approvals outstanding at March 31, 2002 to various small business companies, including the unfunded portion of projects in the construction phase, amounted to approximately $10.6 million. Of these commitments, $3.4 million are for loans to be originated by First Western, a portion of which will be sold into the secondary market. These commitments are made in the ordinary course of our business and, in management s opinion, are generally on the same terms as those to existing borrowers. Commitments to extend credit are agreements to lend to a customer provided that the terms established in the contract are met. Commitments generally have fixed expiration dates and require payment of a fee. Since some commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

PMC Capital and PMC Commercial have entered into indemnification agreements regarding the performance of their respective loans receivable sold to the 2001 Joint Venture and the 2000 Joint Venture. To the extent that poor performance by one of the company s sold loans receivable (the Underperforming Company) is pervasive enough to cause the other company (the Performing Company) to not receive cash flow that it otherwise would have received, then the Underperforming Company must make the Performing Company whole. If the cash flow reduction is considered to be temporary, then interest will be paid as compensation to the Performing Company. If the reduction of cash flows is deemed permanent, the balance of reduction to cash flows must be paid to the Performing Company by the Underperforming Company. At March 31, 2002, our maximum exposure under these indemnification agreements was approximately $17.6 million which represents the value of the Retained Interests reflected on PMC Commercial s consolidated balance sheet. Based on our present cash flow assumptions, including stress test analyses of increasing the anticipated losses on each of the loan pools, it does not appear that the loans receivable sold by us will cause any permanent cash flow reductions to PMC Commercial nor will the loans receivable sold by PMC Commercial cause any permanent cash flow reduction to us. If the performance of our sold loans receivable deteriorated, it could be necessary for us to perform under these indemnification agreements.

Note 9. Recently Issued Accounting Pronouncement:

In April 2002, the Financial Accounting Standards Board (the FASB) issued SFAS No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. The statement, which is effective for financial statements issued for fiscal years beginning after May 15, 2002 and encourages early application, updates, clarifies and simplifies existing accounting pronouncements. Specifically, the statement rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result of this rescission, the criteria in APB Opinion No. 30 will now be used to determine the classification of gains and losses resulting from the extinguishment of debt. The statement also amends SFAS No. 13 to require that when a capital lease is modified in such a way that the change in the lease provisions establishes a new lease which is classified as an operating lease, the asset and lease obligation under the capital lease should be removed, a gain or loss for the difference should be recorded and the new lease should be accounted for as an operating lease. The impact from the implementation of this statement, which we believe will not have a material impact on our consolidated financial statements, will be dependent upon (i) any future debt extinguishments and (ii) whether we enter into capital leases and make subsequent modifications to those leases. As of March 31, 2002, we did not have any capital leases.

Note 10. Subsequent Event:

On April 12, 2002, we completed a structured loan sale transaction of a pool of primarily fixed-rate loans receivable. PMC Capital and PMC Commercial contributed loans receivable of $43.2 million and $27.3 million, respectively, to an SPE (the 2002 Joint Venture). The 2002 Joint Venture issued, through a private placement, approximately $63.5 million of its 2002 Loan-Backed Fixed Rate Notes (the 2002 L.P. Notes) of which approximately $38.9 million (the 2002 PMC L.P. Notes) was allocated to us based on our ownership percentage in the 2002 Joint Venture. The 2002 L.P. Notes, issued at par, which have a stated maturity in 2023 and bear interest at 6.67%, are collateralized by the loans receivable transferred by us and PMC Commercial to the 2002 Joint Venture. The 2002 L.P. Notes were rated Aaa by Moody s Investor Service. We will account for this transaction as a sale and record an estimated gain of approximately $1.5 million and will value our Retained Interests at an initial amount of approximately $8.8 million.

The net proceeds from the issuance of the 2002 PMC L.P. Notes (approximately $38.4 million) were distributed to us. These proceeds are net of our issuance costs and prior to funding the required reserve balance. At inception of the 2002 Joint Venture, we owned a 61.3% limited partnership interest in the 2002 Joint Venture.

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PART I
Financial Information

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

Introduction

Our operations include originating, servicing and selling commercial loans. We primarily originate loans to individuals and small business concerns in the limited service sector of the hospitality industry. We sell certain of our loans receivable through privately-placed structured loan transactions and sell the government guaranteed portion of our loans originated under the Small Business Administration (the SBA) 7(a) program. Historically, we have retained servicing rights and residual interests in all loans sold. Servicing rights include the right to collect payments on behalf of the loan purchaser, monitor the loan receivable for any defaults and address any problems in collecting the required principal and interest payments. We retain a residual interest in the sold loans receivable either directly or through our ownership in the special purpose entities (the SPEs) created in conjunction with our structured loan sale transactions. In addition, we operate as an investment manager to evaluate properties and loans receivable and to service loans receivable and lease contracts pursuant to fee arrangements with our affiliate, PMC Commercial Trust (PMC Commercial).

The following discussion of our financial condition at March 31, 2002 and results of operations for the three months ended March 31, 2002 and 2001 should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2001.

Results of Operations

Overview

Historically, other than loans originated under the SBA 7(a) program, we primarily originated fixed-rate loans and at December 31, 2001, approximately 64% of our retained loans receivable carried fixed rates of interest. During 2001, we commenced marketing and selling a variable-rate loan product based on LIBOR. We commenced this LIBOR lending program as a result of market conditions. During the latter half of 2001, our ability to compete for fixed-rate lending opportunities declined. Interest rates remained at historically low levels for a prolonged period of time providing the banking industry with the ability to offer fixed-rate mini-perm loans (*i.e.,* five-year maturity, 20-year amortization) based on these low short-term rates. In contrast, our fixed-rate loan products are based on a longer term (10-year U.S. Treasuries). As a result, our interest rates offered were higher than the banks and our lending opportunities decreased. We were able to compete more effectively when offering a LIBOR based variable-rate loan product.

Currently, a significant portion of our fundings and our outstanding commitments are based on LIBOR. As of March 31, 2002, our variable-rate loans receivable were $48.7 million (45%) of our loans receivable, an increase of $10.2 million (26%) from December 31, 2001. At March 31, 2002, all of our commitments are for variable-rate loans and given the current interest rate market we expect to continue to originate primarily variable-rate loans.

On April 12, 2002, we completed a structured loan sale transaction of a pool of primarily fixed-rate loans receivable. PMC Capital and PMC Commercial contributed loans receivable of $43.2 million and $27.3 million, respectively, to an SPE (the 2002 Joint Venture). The 2002 Joint Venture issued, through a private placement, approximately $63.5 million of its 2002 Loan-Backed fixed Rate Notes (the 2002 L.P. Notes) of which approximately $38.9 million (the 2002 PMC L.P. Notes) was allocated to us based on our ownership percentage in the 2002 Joint Venture. The 2002 L.P. Notes, issued at par, which have a stated maturity in 2023 and bear interest at 6.67%, are collateralized by the loans receivable transferred by us and PMC Commercial to the 2002 Joint Venture. We will account for this transaction as a sale and will record a gain of approximately

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$1.5 million and will value our retained interests in transferred assets (Retained Interests   ) at an initial amount of approximately $8.8 million.

The net proceeds from the issuance of the 2002 PMC L.P. Notes (approximately $38.4 million) were distributed to us. These proceeds are net of our issuance costs and prior to funding the required reserve balance. At inception of the 2002 Joint Venture, we owned a 61.3% limited partnership interest in the 2002 Joint Venture. These proceeds, plus our previously available cash and cash equivalents, provides us with approximately $50.4 million in available funds to be reinvested. Due to our decreased loan originations, loan commitments and lending opportunities, these funds will be invested in temporary investments for a longer period of time than the proceeds from our past structured loan sale transactions and our results of operations, cash flows and financial conditions will be negatively impacted until the proceeds are fully reinvested.

Lending Activities

The value of our loans receivable was $107.9 million and $107.4 million at March 31, 2002 and December 31, 2001, respectively. During the three months ended March 31, 2002 and 2001, we originated investments in loans totaling $11.8 million and $15.6 million and received repayments, including proceeds from the sale of our guaranteed SBA 7(a) program loans, of $8.9 million (of which approximately $6.0 million represented prepayments) and $3.6 million (of which approximately $132,000 represented prepayments), respectively. During the years ended December 31, 2001 and 2000, we originated $66.0 and $44.2 million of loans, respectively. Our commitments to fund new loans decreased to $10.6 million at March 31, 2002 from $19.5 million at December 31, 2001. See   Liquidity and Capital Resources.   Our serviced loan portfolio decreased by $7.6 million (2%) to $314.2 million at March 31, 2002 from $321.8 million at December 31, 2001.

We experienced increased prepayment activity on our loans receivable as a result of the interest rate environment (the prime rate and yield on treasury notes decreased substantially during 2001), and we believe that we may continue to experience prepayment activity at this higher level during the remainder of 2002. Many of our prepayment charges for our fixed-rate loans receivable are based upon a yield maintenance premium which provides for greater fees as interest rates decrease. In addition, certain of our loans receivable may have a prohibition on prepayment during their initial years. First Western SBLC, Inc. (First Western   s   ) loans receivable (all variable interest rate) did not have any prepayment penalties for loans originated prior to January 2001 in accordance with SBA policy. The SBA changed its policy on prepayment charges to allow the SBA to collect a 5% fee for loans prepaid in the first year, 3% in the second year and 1% in the third year. This change in SBA policy may lessen the amount of prepayments received during the first three years after the origination of an SBA guaranteed loan. The timing and volume of our prepayment activity for both our variable and fixed-rate loans receivable fluctuate and are impacted by numerous factors including the following:

The competitive lending environment (*i.e.,* availability of alternative financing);
The anticipated interest rate environment (*i.e.,* if interest rates are expected to rise or decline); and,
The interest rate on the loan receivable.

When loans receivable are paid-off prior to their maturity, we receive prepayment charges. Prepayment charges result in one-time increases in our income. The proceeds from the prepayments we receive are invested initially in temporary investments and are generally re-loaned or committed to be re-loaned at lower interest rates than the prepaid loans receivable. These lower interest rates have had an adverse effect on our results of operations and depending upon the rate of future prepayments may further impact our results of operations. It is not possible for us to predict the volume or timing of prepayments. The factors listed above are not all-inclusive and changes in one factor are not isolated from changes in others which might magnify or counteract the rate or volume of prepayment activity. When we have significant available cash and cash equivalents on our consolidated balance sheet to be reinvested, the negative impact of prepayments on our results of operations, cash flows and financial condition is extended until this additional cash can be reinvested in long-term higher yielding investments.

At March 31, 2002 and December 31, 2001, approximately $48.7 million and $38.5 million, respectively, of our loans receivable had a variable interest rate (reset on a quarterly basis) based upon either the prime rate or LIBOR. The spread that we charge over the prime rate generally ranges from 1.0% to 2.5%. The spread that we

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charge over LIBOR generally ranges from 3.75% to 4.25%. The prime rate and LIBOR used in determining interest rates for the second quarter of 2002 are 4.75% and 2.03%, respectively.

Historically, we have not had a significant amount of impaired loans nor have we had a significant amount of charged-off loans. Our impaired loans as of March 31, 2002 and December 31, 2001, as a percentage of our loans receivable and sold loans of our SPEs, respectively, are 2.5% and 5.7% and 1.7% and 1.1%, respectively. These balances do not include the principal balance of loans receivable which have been identified as potential problems for which it is expected that a full recovery of the principal balance will be received through either collection efforts or liquidation of collateral (Special Mention Loans). Our Special Mention Loans were $3.7 million (3.4%) and $4.7 million (3.1%), respectively, of our loans receivable and sold loans of our SPEs as of March 31, 2002. In addition, during the first quarter of 2002, we acquired two previously impaired limited service hospitality properties and a previously impaired retail establishment through foreclosure. At March 31, 2002, the aggregate value of these properties, as reduced for anticipated costs of selling, was estimated to be approximately $2.2 million.

Current Economic Factors

Our primary competition has come from banks, financial institutions and other lending companies. Some of these competitors have greater financial and larger managerial resources than us and are able to provide services we are not able to provide (*i.e.,* depository services). In general, we believe we compete effectively with such entities on the basis of the variety of our lending programs offered, interest rates, our long-term maturities and payment schedules, the quality of our service, our reputation as a lender, timely credit analysis and decision-making processes, and renewal and refinancing options available to borrowers. During certain economic environments, our ability to market certain loan products may be reduced. We currently are experiencing reduced fixed-rate lending volume as a result of the current interest rate environment.

During 2001 there were reductions in business and discretionary travel causing a moderation in demand for hotel rooms and a slowdown in construction of hospitality properties. Another factor which affects the limited service sector of the hospitality industry is a significant rise in gasoline prices in a short period of time. As seen in the past, when gas prices sharply increase, occupancy rates decrease. During the first quarter of 2002, we experienced a decrease in loans funded, loan commitments and lending opportunities as compared to the prior year due to the general interest rate environment and an uncertain economy which specifically had an impact on the hospitality sector. As a result of the continuation of low short-term interest rates, banks continue to offer short-term lending at rates considerably lower than our long-term fixed-rate loans. In addition, as a result of the economic uncertainty, fewer hospitality properties have been marketed and there are fewer property sales requiring financing.

Interest rates were lowered in 2001 to aid in stimulating the economy and the Federal Reserve provided liquidity to the economy; however, consumer and business confidence declined. This lack of confidence caused a significant strain on the travel and hotel industries as well as numerous other industries in the United States. However, the limited service area of the hospitality industry continues to outperform the luxury and upscale sectors, with the high-end resort properties experiencing the weakest performance.

As a result of either an increase in competition or an overall decrease in the number of refinancings, we could continue to have a reduced volume of loan originations. The resulting decrease in loan origination volume would affect our results of operations, financial condition and cash flows. To the extent that principal payments on outstanding loans receivable exceeded our loan originations, interest income would be reduced.

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Fluctuations in Quarterly Results

Our quarterly operating results will fluctuate based on a number of factors, including, among others:

- The completion of a structured loan sale transaction in a particular period;
- Interest rates on the securities issued in connection with our structured loan transactions;
- Interest rate changes;
- The volume and timing of loans we originate and the volume and timing of prepayment of our loans receivable;
- Changes in and the timing of the recognition of gains or losses on investments;
- The degree to which we encounter competition in our markets; and
- General economic conditions.

To the extent a structured loan sale transaction is completed, (i) our interest income on loans receivable in future periods will be reduced until the proceeds received are reinvested in new loan originations, (ii) interest expense will be reduced if we repay outstanding debt with the proceeds and (iii) we will earn income from our ownership of a Retained Interest in the loans receivable sold. Until the proceeds are fully reinvested, the net impact of a structured loan sale transaction on future operating periods is a reduction in interest income net of interest expense. As a result of our structured loan sale transaction completed in April 2002, we have $50.4 million in cash and cash equivalents which is temporarily invested in short-term lower yielding investments until these funds can be reinvested in longer term higher yielding investments.

As a result of these factors, results for any quarter should not be relied upon as being indicative of performance in future quarters.

Impact of Recently Issued Accounting Pronouncement

In April 2002, the Financial Accounting Standards Board (the FASB) issued Statement of Financial Accounting Standards (SFAS) No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections. The statement, which is effective for financial statements issued for fiscal years beginning after May 15, 2002 and encourages early application, updates, clarifies and simplifies existing accounting pronouncements. Specifically, the statement rescinds SFAS No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. As a result of this rescission, the criteria in APB Opinion No. 30 will now be used to determine the classification of gains and losses resulting from the extinguishment of debt. The statement also amends SFAS No. 13 to require that when a capital lease is modified in such a way that the change in the lease provisions establishes a new lease which is classified as an operating lease, the asset and lease obligation under the capital lease should be removed, a gain or loss for the difference should be recorded and the new lease should be accounted for as an operating lease. The impact from the implementation of this statement, which we believe will not have a material impact on our financial statements, will be dependent upon (i) any future debt extinguishments and (ii) whether we enter into capital leases and make subsequent modifications to those leases. As of March 31, 2002, we did not have any capital leases.

Three Months Ended March 31, 2002 Compared to the Three Months Ended March 31, 2001

Net operating income and realized and unrealized gain (loss) on investments (net income) decreased by $780,000 (32%), to $1,680,000 during the three months ended March 31, 2002 from $2,460,000 during the three months ended March 31, 2001. The most significant reasons for the decrease in net income was decreases in variable interest rates and a net decrease in our realized and unrealized gains and losses on investments resulting primarily from changes in the valuation of our Retained Interests.

Net operating income decreased by $214,000 (9%), to $2,119,000 during the three months ended March 31, 2002 from $2,333,000 during the three months ended March 31, 2001.

Interest income: Interest income decreased by $547,000 (17%), to $2,607,000 for the three months ended March 31, 2002 from $3,154,000 for the three months ended March 31, 2001. The decrease is primarily due to a decrease in variable interest rates and a decrease in interest earned on idle funds.

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Interest income consisted of the following:

	Three Months Ended March 31,		Increase (Decrease)	
	2002	2001	Amount	Percentage
	(Dollars in thousands)			
Interest income loans	$2,476	$2,822	$(346)	(12.3)%
Commitment fees collected	71	155	(84)	(54.2)%
Interest income other investments	60	177	(117)	(66.1)%
	$2,607	$3,154	$(547)	(17.3)%

The prime rate utilized in the determination of our quarterly variable rates decreased by 475 points from the quarter ended March 31, 2001 to the quarter ended March 31, 2002 (we did not have any LIBOR based loans receivable at March 31, 2001). Our weighted average loans receivable outstanding increased $1.0 million (1%) to $107.6 million at March 31, 2002 from $106.6 million at March 31, 2001. Approximately 45% and 26% of our loans receivable had variable rates of interest as of March 31, 2002 and 2001, respectively.

Income from retained interests in transferred assets: Income from our Retained Interests decreased by $118,000 (9%), to $1,147,000 for the three months ended March 31, 2002 from $1,265,000 for the three months ended March 31, 2001. The income from our Retained Interests is comprised of the yield on our Retained Interests. The annualized yield on our Retained Interests decreased to 12.7% from 14.7%.

Premium income: Premium income increased by $22,000 (20%), to $132,000 for the three months ended March 31, 2002 from $110,000 for the three months ended March 31, 2001. While the proceeds from the sale of the government guaranteed portion of loans receivable (under the SBA 7(a) program) decreased to $1.7 million during the three months ended March 31, 2002 from $2.3 million during the three months ended March 31, 2001, the premium paid by secondary market purchasers was greater during the quarter ended March 31, 2002 compared to the quarter ended March 31, 2001.

Other investment income, net: Other investment income, net, increased by $160,000 (98%), to $323,000 for the three months ended March 31, 2002 from $163,000 for the three months ended March 31, 2001. This increase was primarily attributable to higher prepayment fees for the three months ended March 31, 2002 compared to the three months ended March 31, 2001.

Other income, net: Other income, net, remained constant at $475,000 during the three months ended March 31, 2002 compared to $471,000 during the three months ended March 31, 2001.

Equity in income (loss) of unconsolidated subsidiaries, net: Equity in income (loss) of unconsolidated subsidiaries, net increased by $11,000 (12%), to $101,000 during the three months ended March 31, 2002 from $90,000 during the three months ended March 31, 2001 due primarily to a decrease in the expenses of an unconsolidated subsidiary. As a Business Development Company (BDC), we do not consolidate the operations of our non-investment company subsidiaries. Instead we are required to recognize the income of our non-investment company subsidiaries under the equity method of accounting. Earnings of our unconsolidated subsidiaries, not including the SPEs established by us in connection with the structured sales of our loans receivable, are reflected as a single line item (Equity in income (loss) of unconsolidated subsidiaries, net) in our consolidated statements of income.

Operating expenses, not including interest expense: Operating expenses, excluding interest expense, decreased by $59,000 (4%), to $1,481,000 during the three months ended March 31, 2002 from $1,540,000 during the three months ended March 31, 2001. Operating expenses are comprised of salaries and related benefits, general and administrative, profit sharing plan, rent, legal and accounting, SBA fees and directors and shareholders expense. The primary reason for the decrease was salaries and related benefits which decreased $56,000 (5%), to $1,012,000 during the three months ended March 31, 2002 from $1,068,000 during the three months ended March 31, 2001. The decrease was mainly due to decreased officer compensation.

Interest expense: Interest expense decreased by $195,000 (14%), to $1,185,000 during the three months ended March 31, 2002 from $1,380,000 during the three months ended March 31, 2001. The primary reason for the decrease was a reduction in our weighted average interest rates on our LIBOR based notes payable. Interest expense results primarily from interest on (i) our notes payable ($45.0 million and $41.7 million outstanding as of March 31, 2002 and 2001, respectively) with a weighted average interest rate of 5.2% and weighted average remaining maturity of 2.6 years as of March 31, 2002, (ii) debentures due the SBA ($31.3 million outstanding as of both March 31, 2002 and 2001), with a weighted average interest rate of approximately 7.6% and weighted average remaining maturity of 4.3 years as of March 31, 2002, and (iii) balances outstanding on our revolving credit facility.

Realized and unrealized gain (loss) on investments: Realized and unrealized gain (loss) on investments decreased $566,000 to a loss of $439,000 during the three months ended March 31, 2002 compared to a gain of $127,000 during the three months ended March 31, 2001.

During the three months ended March 31, 2002, unrealized losses on our Retained Interests were $243,000. The primary reasons for the losses during 2002 were (i) a reduction in expected future cash flows resulting from higher than anticipated prepayment activity and (ii) an increase in the discount rates used to value our Retained Interests. During the three months ended March 31, 2001 we recognized $175,000 in valuation gains relating to our Retained Interests. The primary reasons for the net gains during 2001 were (i) lower than anticipated rate of prepayment activity and (ii) less than anticipated loan losses.

We also recognized $122,000 of net loan losses during the three months ended March 31, 2002 compared to $48,000 in net loan losses during the three months ended March 31, 2001. Loan losses (including the change in unrealized appreciation (depreciation) on loans) were 0.83% and 0.48% of our weighted average outstanding loans receivable during the twelve-month periods ended March 31, 2002 and 2001, respectively. In addition, we recorded $74,000 in unrealized losses on our assets acquired in liquidation during the three months ended March 31, 2002.

Cash Flow Analysis

We generated cash flows from operating activities of $392,000 and $3,388,000 during the three months ended March 31, 2002 and 2001, respectively. The primary source of funds from operating activities is our net income. This decrease in source of funds of $2,996,000 primarily relates to (i) the decrease in our net income of $780,000, (ii) a $922,000 increase in use of funds from the change in our operating assets and liabilities and (iii) decreased funds available from our SBA 7(a) lending activity of $1,866,000.

We used cash of $1,016,000 and $13,247,000 in investing activities during the three months ended March 31, 2002 and 2001, respectively. This $12,231,000 decrease in cash flows used in investing activities relates primarily to a net decrease in loans funded less principal collected of $11,044,000 and an increase in proceeds received on our Retained Interests of $1,449,000.

We used cash of $2,434,000 and $3,026,000 in financing activities during the three months ended March 31, 2002 and 2001, respectively. This $592,000 increase in cash flows from financing activities relates to a decrease in our quarterly dividend. See Dividends.

Liquidity and Capital Resources

Sources and uses of funds

Overview

At March 31, 2002, we had approximately $14.3 million of cash and cash equivalents, availability of $10 million under our revolving credit facility, $5 million under our discretionary guidance line facility and approximately $10.6 million of total loan commitments and approvals outstanding. Commitments have fixed expiration dates and require payment of a fee. Since some commitments expire without the proposed loan closing, the total committed amounts do not necessarily represent future cash requirements. After receipt of the net proceeds of $36.1 million (after issuance costs and initial funding of our required reserve balance) from our structured loan sale transaction in April 2002, we have $50.4 million in cash and cash equivalents on hand. Approximately $38 million of the cash and cash equivalents are held by PMC Investment Corporation and Western Financial Capital Corporation. To the extent commitments pertain to PMC Capital and First Western we may need to obtain additional sources of funds as described below.

During the remainder of 2002, we anticipate that our loan originations will range from $20 million to $35 million, which we expect to be funded primarily through the net proceeds received from our April 2002 structured loan sale transaction. If additional sources of funds are needed, we expect to obtain those funds from (i) issuance of notes payable or SBA debentures or (ii) advances under our revolving credit facility. See Loan Originations.

We have $5.0 million in notes payable with an interest rate of 6.97% that mature in December 2002. We anticipate that these notes payable will either be rolled-over into new notes payable with an extended maturity or paid with available cash. We also have a $510,000 SBA debenture that matures in December 2002 and anticipate that we will utilize a portion of our available commitment from the SBA to refinance the SBA debenture or will satisfy the debenture at maturity with cash on hand.

Sources of Funds

General

We expect that funds available as a result of the completion of our structured loan sale transaction, cash on hand and, to the extent necessary, the sources of funds described below should be adequate to meet our existing obligations and generate funds sufficient to meet both our short-term and long-term capital needs. However, there can be no assurance that we will be able to raise additional funds through the financing sources described below.

To continue to generate growth in the size of our investment portfolio and meet our outstanding loan commitments, we will need to obtain additional funds from our primary sources of capital and liquidity as follows:

- The structured loan sale or structured loan financing of a portion of our loans receivable;
- Issuance of SBA debentures;
- Private and public issuances of common stock;
- The issuance of senior unsecured medium-term notes; and
- Borrowings under our short-term, unsecured revolving credit facility and/or guidance line.

As a BDC, we are generally required to maintain a ratio of at least 200% of total assets to total borrowings, which may restrict our ability to borrow in certain circumstances. We expect to be able to borrow from financial institutions and sell loans receivable in the asset-backed securities market. As a result of the current market price for our common stock, we do not anticipate selling additional equity securities during the year ending December 31, 2002.

Additional sources of capital include principal and interest collections on our existing loans receivable, the cash flows from our Retained Interests and proceeds from the sale of SBA 7(a) loans receivable in the secondary market. However, to the extent these sources represent taxable income (*i.e.,* interest income, etc.), such amounts have historically been distributed to our shareholders as dividends. As a result, those earnings are generally not available to fund future investments.

In addition, we believe that as a result of the current interest rate environment (the prime rate and the yield on treasury notes decreased substantially during 2001) we may continue to experience prepayment activity at a higher level during the remainder of 2002.

Structured Loan Sale Transactions

Since 1996, our primary source of funds has been structured loan sale transactions. We have generated net proceeds of $38.4 million, $44.5 million and $24.7 million from the completion of structured loan sale transactions during 2002, 2001 and 2000, respectively. The cash flows from our Retained Interests are increasing as a result of these structured loan sale transactions.

Since we rely on structured loan sale transactions as our primary source of operating capital to fund new loan originations, any adverse changes in our ability to complete this type of transaction, including any reduction in the market for the type of asset-backed securities we generate, could have a detrimental effect on our ability to sell loans receivable thereby reducing our ability to originate loans.

Debt

At March 31, 2002, we did not have any borrowings outstanding under our $10 million revolving credit facility or our $5 million discretionary guidance line, thus providing credit availability of $15 million. Advances pursuant to the credit facility bear interest at our option at either the lender s prime rate less 50 basis points or LIBOR plus 175 basis points. The credit facility requires that we meet certain covenants, the most restrictive of which provides that the ratio of net charge-offs to net loans receivable may not exceed 2%, and the ratio of assets to debt may not fall below 110% for PMC Capital and 135% including our consolidated subsidiaries. At March 31, 2002, we were in compliance with all covenants of this facility.

At March 31, 2002, we had an outstanding commitment from the SBA, expiring December 31, 2002, to purchase up to $5.2 million ($4.2 million expiring September 2003 and $1.0 million expiring September 2004) in additional SBA debentures.

Uses of Funds

General

Our primary use of funds is to originate loans to small businesses in the limited service hospitality industry. We also use funds primarily for payment of:

- Dividends to shareholders;
- Principal payments on borrowings;
- Interest and related financing costs; and,
- Salaries and other general and administrative expenses.

As a regulated investment company, pursuant to the Internal Revenue Code of 1986, as amended, we are required to pay out substantially all of our net investment company taxable income to our common shareholders. See Dividends.

Loan Originations

As of March 31, 2002, our commitments of approximately $10.6 million were significantly less than commitments of $54.0 million at March 31, 2001. We anticipate that quarterly loan volumes (which averaged approximately $16.5 million per quarter in 2001 and were $11.8 million during the first quarter of 2002) will range from $3 million to $12 million per quarter in 2002 and the loan origination volume for all of 2002 will range from $35 million to $50 million. Commitments outstanding historically have ranged from $25 million to $30 million. Our reduction in outstanding commitments is a result of numerous factors including the following:

- The uncertain economic environment that has continued since September 2001, including the performance of limited service hospitality properties;
- Interest rates have remained low and stable for a prolonged period of time. As a result, refinancing opportunities have declined since a significant portion of these opportunities would have already been refinanced;
- Continued weakness in selective geographic markets;

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Continued decline in new lodging construction as a result of the uncertain economic climate and aggressive construction prior to 2002; and,

Buyers are deferring decisions on potential acquisitions in order to better assess potential opportunities.

The proceeds from the prepayments we receive and from the completion of our structured loan sale transactions are invested initially in temporary investments which generate less interest income and have generally been re-loaned or committed to be re-loaned at lower interest rates than the prepaid loans receivable. These lower interest rates have had an adverse effect on our results of operations and depending upon the rate of future prepayments may further impact our results of operations.

Summarized Contractual Obligations, Commitments and Contingencies

The following summarizes our contractual obligations at March 31, 2002:

	Payments Due by Period				
Contractual Obligations	**Total**	**Less than 1 year**	**1 to 3 years**	**4 to 5 years**	**After 5 years**
			(In thousands)		
Long-term debt (1)	$76,310	$5,510	$29,000	$34,490	$ 7,310
Preferred stock (2)	4,000				4,000
Operating leases (3)	520	284	236		
Employment agreements (4)	2,666	1,185	1,481		
Total contractual cash obligations	$83,496	$6,979	$30,717	$34,490	$11,310

(1) *In addition, we have a $10 million revolving credit facility and a $5 million guidance line facility. No amounts were outstanding under either of these facilities as of March 31, 2002.*

(2) *The 4% preferred stock of our subsidiary was issued in 1994 ($2.0 million) and 1995 ($2.0 million) and must be redeemed at par no later than 15 years from the date of issuance.*

(3) *Represents our future minimum lease payments under our leases for office space.*

(4) *We have employment agreements with certain of our officers.*

Our commitments at March 31, 2002 are summarized as follows:

		Amount of Commitment Expiration Per Period			
Other Commitments	**Total Amounts Committed**	**Less than 1 year**	**1 to 3 years**	**4 to 5 years**	**Over 5 years**
			(In thousands)		
Indemnification (1)	$	$	$	$	$
Environmental (2)					
Other commitments (3)	10,617	10,617			
Total commitments	$10,617	$10,617	$	$	$

(1) *Represents our cross indemnification with PMC Commercial related to the SPEs created in conjunction with our structured loan sale transactions completed in 2001 and 2000 with a maximum exposure at March 31, 2002 of $17.6 million as discussed in detail below.*

(2) *Represents a liability of $0.3 million reflected on the balance sheet of PMC Funding, our non-consolidated, non-investment company act subsidiary. The liability represents the estimated remaining costs to remediate an environmental obligation relating to an asset acquired through liquidation and subsequently sold during 1999 by PMC Funding. We cannot currently estimate when or if the obligation may be required to be paid. There can be no assurance of the accuracy of this estimate.*

(3) *Represents our loan commitments and approvals outstanding.*

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In a structured loan sale transaction, we contribute loans receivable to a special purpose entity in exchange for an ownership interest in that entity. The special purpose entity issues notes payable (usually through a private placement) to third parties and then distributes a portion of the note payable proceeds to us. The notes payable are collateralized solely by the assets of the special purpose entity which means that should the special purpose entity fail to make payments on the notes, the noteholders have no recourse to us. We have no obligation to pay the notes, nor do the holders of the notes have any recourse against our assets. Accordingly, neither the assets contributed to the special purpose entities nor the notes payable issued by the special purpose entity are included in our consolidated financial statements.

PMC Capital and PMC Commercial have entered into indemnification agreements regarding the performance of their respective loans receivable sold to the SPEs created in conjunction with our structured loan sale transactions completed in 2001 and 2000. To the extent that poor performance by either company s sold loans receivable (the Underperforming Company) is pervasive enough to cause the other company (the Performing Company) to not receive cash flow that it otherwise would have received, then the Underperforming Company must make the Performing Company whole. If the cash flow reduction is considered to be temporary, then interest will be paid as compensation to the Performing Company. If the reduction of cash flows is deemed permanent, the balance of reduction to cash flows must be paid to the Performing Company by the Underperforming Company. At March 31, 2002, our maximum exposure under these indemnification agreements was approximately $17.6 million which represents the value of the Retained Interests reflected on PMC Commercial s consolidated balance sheet. Based on our present cash flow assumptions, including stress test analyses of increasing the anticipated losses on each of the loan pools, it does not appear that the loans receivable sold by us will cause any permanent cash flow reductions to PMC Commercial nor will the loans receivable sold by PMC Commercial cause any permanent cash flow reduction to us. If the performance of our sold loans receivable deteriorated, it could be necessary for us to perform under these indemnification agreements.

On April 12, 2002, we completed another structured loan sale transaction with PMC Commercial. PMC Capital and PMC Commercial entered into an indemnification agreement regarding the performance of their respective loans receivable sold to the SPE created in conjunction with this structured loan sale. The terms and conditions of the indemnification agreement are identical to those related to our structured loan sale transactions completed in 2001 and 2000 described above. Our maximum exposure under this indemnification agreement is expected to be approximately $5.2 million which represents the value of the Retained Interests we anticipate will be recorded on PMC Commercial s consolidated balance sheet in the second quarter of 2002.

At the time a structured loan sale transaction is completed, we enter into Credit Enhancement Agreements that govern the assets and the flow of funds in and out of the special purpose entity formed as part of the structured loan sale transaction. Generally, the Credit Enhancement Agreements contain specified limits on the delinquency, default and loss rates on loans receivable included in each special purpose entity. If, at any measurement date, the delinquency, default or loss rate with respect to any special purpose entity were to exceed the specified limits, provisions of the Credit Enhancement Agreements would automatically increase the level of credit enhancement requirements for that special purpose entity. During the period in which the specified delinquency, default or loss rate was exceeded, excess cash flow from the special purpose entity, if any, would be used to fund the increased credit enhancement levels instead of being distributed to us, which would delay our distribution or could reduce our cash flow. To date, we have not had a reduction of cash flow as a result of an increased credit enhancement requirement associated with our structured loan transactions.

Investment Company Act Requirements

PMC Capital is in compliance with the requirement to maintain a minimum of 200% asset coverage of debt as defined in sections 18 and 61 of the Investment Company Act of 1940, as amended, as modified by exemptive orders obtained by us from the Securities and Exchange Commission.

Dividends

PMC Capital has historically paid dividends equal to at least 100% of its investment company taxable income. There are certain timing differences between book and tax income, most notably the recognition of

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income relating to our structured loan transactions. As a result of these timing differences and the anticipation of cash flows from the SPEs, the payment and amount of dividends does not necessarily coincide with our earnings and we may have a distribution of dividends in excess of our net income. In addition, our dividends paid since we became an investment company exceeded our earnings and profits for tax purposes. We did not recognize any return of capital for dividend reporting purposes during the year ended December 31, 2001. The computation of return of capital provides for several timing differences, most notably relating to the recognition of gain treatment on structured loan transactions.

During December 2001, we declared a $0.20 per share dividend to common shareholders of record on December 31, 2001, which was paid during January 2002. On March 18, 2002, our Board of Directors (the Board) declared a dividend of $0.16 per common share for the first quarter of 2002. The Board reduced the quarterly dividend after consideration of the impact of lower short-term interest rates and diminished interest rate spreads. Our Board may amend our dividend policy as warranted by actual and/or anticipated earnings.

Risks Associated with Forward-Looking Statements Included in this Form 10-Q

This Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which are intended to be covered by the safe harbors created thereby. These statements include the plans and objectives of management for future operations, including plans and objectives relating to future growth of the loan portfolio and availability of funds. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties identified in this Form 10-Q. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could be inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this Form 10-Q will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

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ITEM 3.
Quantitative and Qualitative Disclosures About Market Risk

Since our consolidated balance sheet consists of items subject to interest rate risk, we are subject to market risk associated with changes in interest rates as described below.

Of our loans receivable at March 31, 2002, approximately 55% bear fixed rates of interest and, as a result, changes in interest rates do not have an immediate impact on interest income with regard to these loans receivable. Our interest rate risk on our fixed-rate loans receivable is primarily related to loan prepayments and pay-offs. The average maturity of our loans receivable is less than their average contractual terms because of prepayments. The average life of mortgage loans tends to increase when the current mortgage loan rates are substantially higher than rates on existing mortgage loans and, conversely, decrease when the current mortgage loan rates are substantially lower than rates on existing mortgage loans (due to refinancings of fixed-rate loans).

As of March 31, 2002, we had $48.7 million of variable-rate loans receivable and $25.0 million of variable-rate debt. On the $23.7 million differential between our variable-rate loans receivable outstanding and our variable-rate debt we have interest rate risk. To the extent variable rates continue to decrease we would have a net decrease in interest income. In addition, the majority of our variable-rate loans are based on the prime rate while our variable-rate debt is based on LIBOR. To the extent that the differential between the prime rate and LIBOR were to change and the prime rate did not change while LIBOR increased, we would have a negative impact on net income. An increase in the spread between the prime rate and LIBOR of 100 basis points would reduce net income by $250,000.

The sensitivity of our variable-rate loans receivable and debt to changes in interest rates is regularly monitored and analyzed by measuring the characteristics of our assets and liabilities. We assess interest rate risk in terms of the potential effect on interest income net of interest expense, the value of net assets and the value at risk in an effort to ensure that we are insulated from any significant adverse effects from changes in interest rates. Based on our analysis of the sensitivity of interest income net of interest expense, if the consolidated balance sheet were to remain constant and no actions were taken to alter the existing interest rate sensitivity, a hypothetical immediate 100 basis point reduction in interest rates would have reduced net income by approximately $237,000 or 2% over a one-year period.

Changes in market interest rates are considered by the Board in its determination of fair value of our loans receivable. To date, changes in market interest rates have not had a significant effect on the Board determination. However, future interest rate changes could have an impact. Significant reductions in interest rates, however, can prompt increased prepayments of our loans receivable, resulting in possible decreases in long-term revenues due to the re-lending of the prepayment proceeds at lower interest rates.

We have an investment in Retained Interests which is valued by our Board based on various factors including estimates of appropriate market discount rates. As there is no quoted market value for our Retained Interests, changes to the general interest rate environment may not affect our discount rates. Significant changes in the discount rates used by the Board in determining the fair value of the Retained Interests will have an impact on the recorded value and future earnings. Assuming all other factors (*i.e.,* prepayments, losses, etc.) remain unchanged, if the discount rates used by the Board were to increase by 100 basis points or 200 basis points from current rates, the value of our Retained Interests and our net income would decrease by approximately $1.2 million and $2.4 million, respectively.

Although management believes that the above described measures are indicative of our sensitivity to interest rate changes, it does not adjust for potential changes in credit quality, size and composition of our consolidated balance sheet and other business developments that could affect our net income. Accordingly, no assurances can be given that actual results would not differ materially from the potential outcome simulated by these estimates.

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PART II
Other Information

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 6. Exhibits and Reports on Form 8-K

A. Exhibits

None

B. Reports on Form 8-K

None

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Signatures

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

		PMC Capital, Inc.
Date:	5/15/02	/s/ Lance B. Rosemore
		Lance B. Rosemore President
Date:	5/15/02	/s/ Barry N. Berlin
		Barry N. Berlin Chief Financial Officer (Principal Accounting Officer)

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font-family:inherit;font-size:10pt;">equivalent) ratings from recognized rating agencies.

Municipal bonds are classified as held to maturity, are carried at amortized cost and are included in other assets per the consolidated balance sheet. Differences between amortized cost and fair value of municipal bonds are not considered material. Auction rate securities are classified as available-for-sale and therefore are carried at fair value as estimated using Level 3 fair value inputs. The amortized cost and fair value of available-for-sale investments at September 30, 2011 and December 31, 2010 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)			
September 30, 2011				
Current:				
Auction rate student loan educational bonds	$11,325	$—	$—	$11,325
	$11,325	$—	$—	$11,325
Long-term:				
Auction rate student loan educational bonds	$56,225	$—	$3,081	$53,144
	$56,225	$—	$3,081	$53,144
	$67,550	$—	$3,081	$64,469
December 31, 2010				
Current:				
Auction rate student loan educational bonds	$8,300	$—	$—	8,300
	$8,300	—	$—	$8,300
Long-term:				
Auction rate student loan educational bonds	$83,475	$—	$3,081	$80,394
	$83,475	—	$3,081	$80,394
	$91,775	—	$3,081	$88,694

The contractual maturities and announced calls of available-for-sale securities at September 30, 2011 are detailed in the table below. The table is prepared based on information known to management as of September 30, 2011. As management receives intents to call from issuers, the associated securities are changed from their contractual maturities to the date received in the respective call notice.

	Fair Value	Amortized Cost
Due within one year	$11,325	$11,325
Due after one year through five years	—	—
Due after five years through ten years	—	—
Due after ten years through May 1, 2040	53,144	56,225
	$64,469	$67,550

The guidance under U.S. GAAP defines fair value, specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable, and requires disclosures about fair value measurements. The Company estimates the fair value of the auction rate securities applying the authoritative guidance on fair value measurements which establishes fair value as an estimate of what the Company could sell the investments for in an orderly transaction with a third party as of each measurement date. Observable inputs are inputs that reflect market data obtained from sources independent of the Company and unobservable inputs are inputs based on the Company's own assumptions derived from the best information available in the circumstances. These inputs are used in applying the following fair value hierarchy:

- Level 1 – quoted prices in active markets for identical assets or liabilities.

- Level 2 – quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; modeling with inputs that have observable inputs (i.e. interest rates observable at commonly quoted intervals.
- Level 3 – valuation is generated from model-based techniques that use significant assumptions not observable in the market.

Under the guidance, where applicable GAAP literature requires the use of fair value, the Company must value assets and liabilities at 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. Additional authoritative literature provides guidance regarding the considerations necessary when markets are inactive. The guidance indicates that quotes from brokers or pricing services may be relevant inputs when measuring fair value, but are not necessarily determinative in the absence of an active market for the asset.

As of September 30, 2011, all of the Company's auction rate student loan bonds were associated with unsuccessful auctions. As such, the estimated fair value of the underlying investments had declined below amortized cost of the investments as a result of liquidity issues in the auction rate markets. To date, there have been no instances of delinquencies or non-payment of applicable interest from the issuers and all calls of securities by the issuers have been at par value plus accrued interest. Since the first auction failures in February 2008 when the Company had approximately $198.5 million ARS at par, the Company has received approximately $142.2 million of calls from issuers, at par, plus accrued interest at the time of the call. This includes $2.6 million and $24.2 million received in the three and nine months ended September 30, 2011, respectively, and $11.3 million received subsequent to September 30, 2011. Accrued interest income is included in other current assets in the consolidated balance sheet.

Until auction failures began, the fair value of these investments were calculated using Level 1 observable inputs and fair value was deemed to be equivalent to amortized cost due to the short-term and regularly occurring auction process. Based on auction failures beginning in mid-February 2008 and continued failures through September 30, 2011, there were no significant observable quoted prices or other relevant inputs for identical or similar securities. Estimated fair value of all auction rate security investments as of September 30, 2011 and December 31, 2010 was calculated using unobservable, Level 3 inputs, due to the lack of observable market inputs specifically related to student loan ARS. The fair value of these investments as of the September 30, 2011 and December 31, 2010 measurement dates could not be determined with precision based on lack of observable market data and could vary significantly in future measurement periods.

The Company performs an internal cash flow analysis on an individual investment basis to estimate fair value of ARS using inputs determined based on management's understanding of market conditions as well as information derived from other publicly available third party sources. This approach considers the anticipated estimated outstanding average life of the underlying student loans (range of 2 to 12 years) that are the collateral to the trusts, principal outstanding, expected rates of returns over the average life of the underlying student loans using forward rate curves, and payout formulas. Management also uses notices received of intent to call certain securities before their contractual maturities within the cash flow models. The range of estimated outstanding lives is based on call notices received by the Company, communications with trusts, and communications with third party financial institutions. These underlying cash flows, by individual investment, were discounted using interest rates consistent with instruments of similar quality and duration adjusted for a lack of liquidity in the market. The Company also obtains estimated fair value of ARS from third party financial advisors. The Company obtains an understanding of assumptions in models used by third party financial institutions to estimate fair value. All of this information is considered when determining the estimated fair value of these instruments as recorded in the consolidated financial statements. The Company's discounted cash flow approach requires the use of multiple input factors including an estimated rate of return, base discount rate, and a liquidity discount rate to reflect the current lack of liquidity of ARS in capital markets due to auction failures. We understand that models employed by the Company's third party financial advisors are also subject to changes in similar input factors. As such, the fair value of ARS is subject to change based on significant changes to the underlying input factors. The Company has analyzed the potential impact of a 50 basis point change to the rate of return, discount rate, and liquidity discount rate noting that this would not materially impact the recorded fair value.

The table below shows the inputs in the Company's cash flow models as of September 30, 2011 for the remaining ARS investments compared to the inputs used in cash flow models as of December 31, 2010. Inputs used in Company models of all securities held as of September 30, 2011 and December 31, 2010, excluding investments whose fair value is estimated to be par value as of the reporting period due to call notices being received by the Company were as follows:

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	September 30, 2011	December 31, 2010
Average life of underlying loans	2-12 years	2-12 years
Rate of return	0.70-2.62%	1.28-4.12%
Discount rate	0.28-0.93%	0.53-1.85%
Liquidity discount rate	0.55-0.97%	0.40-0.80%

The unrealized loss of $3.1 million is recorded as an adjustment to accumulated other comprehensive loss and the Company has not recognized any other than temporary impairments in the consolidated statements of income. There were not any realized gains or losses related to these investments for the three and nine month periods ended September 30, 2011 and 2010. The Company can not currently project when liquidity will be obtained from these investments and plans to continue to hold such securities until the securities are called, redeemed, or resecuritized by the debt issuers.

The Company has evaluated the unrealized loss on these securities to determine whether the decline in fair value is other than temporary. Management has concluded the decline in fair value to be temporary based on the following considerations.

- Since auction failures began in February 2008, the Company has received approximately $142.2 million as the result of calls by issuers which includes $2.6 million and $24.2 million in calls, received during the three and nine months ended September 30, 2011 and $11.3 million subsequent to September 30, 2011. The Company received par value for the amount of these calls plus accrued interest. There have not been any defaults on scheduled interest payments.
- Based on the Company's financial operating results, current cash balances, operating cash flows and debt free balance sheet, the Company does not have the intent to sell such securities at a discount and it is not more likely than not to be required to sell the securities before they recover their value.
- There have not been any significant changes in collateralization and ratings of the underlying securities since the first failed auction. All of the Company's auction rate security portfolio, as of September 30, 2011, is in senior positions of AAA (or equivalent) rated securities that are backed by the U.S. government.
- The Company is aware of recent increases in default rates of the underlying student loans that are the assets to the trusts issuing the auction rate security debt, which management believes is due to current overall negative economic conditions. As the underlying loans are guaranteed by the U.S. Government, defaults of the loans accelerate payment of the underlying loan to the trust. As trusts are no longer recycling repayment money for new loans, accelerated repayment of any student loan to the underlying trust would increase cash flows of the trust which would potentially result in partial calls by the underlying trusts.
- As trusts are no longer recycling underlying loan repayment money for new loans, excess funds are being used to pay down debt of the trust therefore potentially resulting in partial calls of securities held by the Company.
- The Company is aware of recent transactions taking place in secondary markets as well as tender offers for ARS at sub par pricing. The Company does not intend to tender any holdings at sub par pricing. As ARS debt holders tender ARS debt back to trusts at sub par pricing, the overall equity of the trusts is strengthened.
- Current market activity and the lack of severity or extended decline do not warrant such action at this time.

Management will monitor its investments and ongoing market conditions in future periods to assess impairments considered to be other than temporary. Should fair value continue to remain below cost or decrease significantly from current levels due to credit related issues, the Company may be required to record an impairment of these investments, through a charge in the consolidated statement of income although the factors currently do not warrant such a charge.

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The table below presents a reconciliation for all assets and liabilities, measured at fair value, on a recurring basis using significant unobservable inputs (Level 3) during the three months ended September 30, 2011 and 2010.

	Available-for-sale debt securities (in thousands)	
	2011	2010
Balance, January 1	$88,694	$147,419
Settlements	(24,225)	(50,325)
Purchases	—	—
Issuances	—	—
Sales	—	—
Transfers in to (out of) Level 3	—	—
Total gains or losses (realized/unrealized):		
Included in earnings	—	—
Included in other comprehensive loss, net of tax	—	2,500
Balance, September 30,	$64,469	$99,594

Note 6. Property, Equipment, and Depreciation

Property and equipment are reported at cost, net of accumulated depreciation, while maintenance and repairs are charged to operations as incurred. Tires are capitalized separately from revenue equipment and are reported separately as “Prepaid Tires” and amortized over two years. Depreciation expense of $0.2 million and $0.5 million for the three and nine months ended September 30, 2011 has been included in communication and utilities in the consolidated statements of income. Depreciation for financial statement purposes is computed by the straight-line method for all assets other than tractors. Effective January 1, 2009, the Company changed its estimate of depreciation expense on tractors acquired subsequent to January 1, 2009, to 150% declining balance, to better reflect the estimated trade value of the tractors at the estimated trade date. Tractors acquired prior to December 31, 2008 will continue to be depreciated using the 125% declining balance method. Approximately 89% of the Company's current tractor fleet were purchased after January 1, 2009 and therefore are being depreciated using the 150% declining balance method of depreciation. Tractors are depreciated to salvage values of $15,000 while trailers are depreciated to salvage values of $4,000.

Note 7. Earnings per Share

Earnings per share are based upon the weighted average common shares outstanding during each year. The Company has no common stock equivalents; therefore, diluted earnings per share are equal to basic earnings per share.

Note 8. Dividends

During the three months ended September 30, 2011, the Company’s Board of Directors declared a regular quarterly dividend totaling $1.8 million. This dividend was paid subsequent to September 30, 2011 and therefore was accrued and included as part of accounts payable and accrued liabilities in the consolidated balance sheets as of September 30, 2011. Future payment of cash dividends and the amount of such dividends will depend upon financial conditions, results of operations, cash requirements, tax treatment, and certain corporate law requirements, as well as factors deemed relevant by our Board of Directors.

Note 9. Income Taxes

Deferred income taxes are determined based upon the differences between the financial reporting and tax basis of the Company's assets and liabilities. Deferred taxes are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. The Company records interest and penalties related to unrecognized tax benefits in income tax expense. The Company had recorded a valuation allowance of $1.1 million at September 30, 2011 and December 31, 2010 related to the Company's deferred tax asset associated specifically with unrealized losses on auction rate securities. This valuation allowance was recorded as the Company does not have historical capital gains nor does it expect to generate capital gains sufficient to utilize the entire deferred tax asset generated by the fair value adjustment. As the fair value adjustment was recorded through accumulated other comprehensive loss, the associated valuation allowance was also recorded through accumulated other comprehensive loss. The above mentioned allowance did not impact the consolidated statement of income for the three and nine months ended September 30, 2011 and 2010. The Company has not recorded a valuation allowance against any other deferred tax assets. In management's opinion, it is more likely than not that the Company will be able to utilize these deferred tax assets in future periods as a result of the Company's history of profitability, taxable income, and reversal of deferred tax liabilities.

At September 30, 2011 and December 31, 2010, the Company had a total of $15.7 million and $18.1 million in gross unrecognized tax benefits, respectively. Of this amount, $10.1 million and $11.7 million represents the amount of unrecognized tax benefits that, if recognized, would impact our effective tax rate as of September 30, 2011 and December 31, 2010. Unrecognized tax benefits were a net increase of approximately $0.3 million and $0.3 million during the quarters ended September 30, 2011 and September 30, 2010 due to additions based on tax positions related to the current year with no offsetting reductions due to lapses of applicable statute of limitations due to filing dates of respective tax returns. Unrecognized tax benefits were a net decrease of $2.5 million and $2.9 million during the nine months ended September 30, 2011 and 2010, due mainly to the expiration of certain statutes of limitation net of additions. This had the effect of reducing the effective state tax rate during these respective periods. The total net amount of accrued interest and penalties for such unrecognized tax benefits was $7.8 million and $9.2 million at September 30, 2011 and December 31, 2010 and is included in income taxes payable per the consolidated balance sheet. Net interest and penalties included in income tax expense for the three month periods ended September 30, 2011 and 2010 was an expense of approximately $0.2 million and $0.2 million, respectively. Net interest and penalties included in income tax expense for the nine month periods ended September 30, 2011 and September 30, 2010 was a benefit of approximately $1.4 million and $1.6 million, respectively. Income tax expense is increased each period for the accrual of interest on outstanding positions and penalties when the uncertain tax position is initially recorded. Income tax expense is reduced in periods by the amount of accrued interest and penalties associated with reversed uncertain tax positions due to lapse of applicable statute of limitations, when applicable. Additional income tax expense during the three month periods ended September 30, 2011 and September 30, 2010 was a result of penalties and interest accruing on uncertain tax positions with no reversals of prior period accruals due to lapse of applicable statute of limitations. Income tax expense was reduced during the nine months ended September 30, 2011 and September 30, 2010 due to reversals of interest and penalties due to lapse of applicable state of limitations net of additions for interest and penalty accruals during the same period. These unrecognized tax benefits relate to risks associated with state income tax filing positions for the Company's corporate subsidiaries.

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

	(in thousands)
Balance at December 31, 2010	$18,140
Additions based on tax positions related to current year	831
Additions for tax positions of prior years	—
Reductions for tax positions of prior years	(15)
Reductions due to lapse of applicable statute of limitations	(3,278)
Settlements	—
Balance at September 30, 2011	$15,678

A number of years may elapse before an uncertain tax position is audited and ultimately settled. It is difficult to predict the ultimate outcome or the timing of resolution for uncertain tax positions. It is reasonably possible that the amount of unrecognized tax benefits could significantly increase or decrease within the next twelve months. These changes could result from the expiration of the statute of limitations, examinations or other unforeseen circumstances. As of September 30, 2011, the Company is under examinations by two state agencies. The Company has also been notified of the intent of the IRS to exam the Company's federal tax return for 2009. The Company does not have any outstanding litigation related to tax matters. At this time, management's best estimate of the reasonably possible change in the amount of gross unrecognized tax benefits to be a decrease of approximately $0.3 million to $1.3 million during the next twelve months mainly due to the expiration of certain statute of limitations. The federal statute of limitations remains open for the years 2008 and forward. Tax years 2001 and forward are subject to audit by state tax authorities depending on the tax code and administrative practice of each state.

Note 10. Equity

In September, 2001, the Board of Directors of the Company authorized a program to repurchase 15.4 million shares, adjusted for stock splits, of the Company's common stock in open market or negotiated transactions using available cash, cash equivalents and investments. The authorization remains open at September 30, 2011 and has no expiration date. There were 2.2 million shares repurchased in the open market during the three and nine months ended September 30, 2011 of which $28.8 million was paid for in the three and nine month periods ended September 30, 2011 and $0.8 million was paid subsequent to September 30, 2011. The repurchased shares were accounted for as treasury stock and are available to be reissued. Shares purchased under the program prior to 2011 were retired. No shares were repurchased during the three and nine months ended September 30, 2010. The repurchase program may be suspended or discontinued at any time without prior notice. Approximately 4.3 million shares remain authorized for repurchase under the program as of September 30, 2011.

On July 11, 2011, a Special Meeting of Stockholders of Heartland Express, Inc. was held, at which meeting the approval of the Heartland Express, Inc. 2011 Restricted Stock Award Plan (the "Plan") was ratified. The Plan will make available up to 0.9 million shares for the purpose of making restricted stock grants to eligible officers and employees of the Company. As of the date of filing this Quarterly Report on Form 10-Q, there were no grants of shares under the Plan.

Note 11. Commitments and Contingencies

The Company is a party to ordinary, routine litigation and administrative proceedings incidental to its business. In the opinion of management, the Company's potential exposure under pending legal proceedings is adequately provided for in the accompanying consolidated financial statements.

The Company has entered into commitments to further execute management's plan to upgrade the Company's existing tractor and trailer fleets. Delivery of tractor equipment under the current program began in the third quarter of 2010 and is expected to be completed in the fourth quarter of 2011. In addition, the Company has purchase commitments outstanding for deliveries of new trailer equipment which is also expected to be completed in the fourth quarter of 2011. The total estimated net purchase commitments, net of estimated trade values on tractors, at September 30, 2011 is currently estimated at $17.0 million. Although the Company expects to continue to sell trailers throughout the remainder of 2011 to provide additional sources of cash flows for new trailers, there were no guaranteed commitments from third parties as of September 30, 2011 to buy trailers. Therefore, expected sale proceeds for trailer sales are not reflected as a reduction of the outstanding purchase commitment.

Note 12. Subsequent Events

The Company has evaluated events occurring subsequent to September 30, 2011 through the filing date of this Quarterly Report on Form 10-Q for disclosure. Subsequent to September 30, 2011 the Company repurchased 1.2 million shares of common stock for $16.4 million. The repurchased shares were accounted for as treasury stock and are available to be reissued. There were no other events subsequent to September 30, 2011, requiring disclosure.

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

This Item 2 contains certain statements that may be considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and such statements are subject to the safe harbor created by such sections. All statements, other than statements of historical fact, are statements that could be deemed forward-looking statements, including without limitation: any projections of earnings, revenues, or other financial items; any statement of plans, strategies, and objectives of management for future operations; any statements concerning proposed new services or developments; any statements regarding future economic conditions or performance; and any statements of belief and any statement of assumptions underlying any of the foregoing. Such statements may be identified by their use of terms or phrases such as "expects," "estimates," "projects," "believes," "anticipates," "intends," "may" "could, " and similar terms and phrases. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified, which could cause future events and actual results to differ materially from those set forth in, contemplated by, or underlying the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Item 1A. Risk Factors," set forth in the Company's Annual Report on Form 10-K, which is by this reference incorporated herein. Readers should review and consider the factors discussed in "Risk Factors" of the Company's Annual Report on Form 10-K, along with various disclosures in our press releases, stockholder reports, and other filings with the Securities and Exchange Commission.

All such forward-looking statements speak only as of the date of this Quarterly Report. You are cautioned not to place undue reliance on such forward-looking statements. The Company expressly disclaims any obligation or undertaking to release publicly any updates or revisions to any forward-looking statements contained herein to reflect any change in the Company's expectations with regard thereto or any change in the events, conditions, or circumstances on which any such statement is based.

Overview

Heartland Express, Inc. is a short-to-medium haul truckload carrier with corporate headquarters in North Liberty, Iowa and operating office and shop combined regional terminal locations in nine states and two shop only locations outside of Iowa. The Company provides regional dry van truckload services through its regional terminals plus its corporate headquarters. The Company transports freight for major shippers and generally earns revenue based on the number of miles per load delivered. The Company's eleven regional operating divisions, not including operations at the corporate headquarters, accounted for 73.2%, and 71.0% of the operating revenues for the three months ended September 30, 2011 and 2010, and 72.7% and 71.2% of the operating revenues for the nine months ended September 30, 2011 and 2010, respectively. The Company takes pride in the quality of the service that it provides to its customers. The keys to maintaining a high level of service are the availability of late-model equipment and experienced drivers.

Operating efficiencies and cost controls are achieved through equipment utilization, operating a fleet of late model equipment, maintaining an industry leading driver to non-driver employee ratio, and the effective management of fixed and variable operating costs.   During 2010 industry capacity tightened and demand for freight services has increased in 2011 although current freight volumes are still below volumes experienced prior to the recent recession. The tightening capacity in the industry with an increase in freight volumes, compared to 2009, allowed for stabilization and certain improvements in freight rates during late 2010 which continued into 2011. The Company has experienced increasing difficulties attracting and retain qualified drivers. The Company continues to be challenged by a shrinking pool of qualified drivers. Competition for drivers, which is always intense, has escalated during 2011 due to general improvements in the demand for freight services.

As fuel prices soared to historical highs during 2008, containment of fuel cost became a top priority of management. The Company continues to implement fuel initiative strategies to effectively manage fuel costs since that time, and into 2011. These initiatives included strategic fueling of our trucks whether it be terminal fuel or over-the-road fuel, reduction of tractor idle time, controlling out-of-route miles, and increased fuel economy through the purchase of newer more fuel efficient tractors. These initiatives continue to prove beneficial throughout 2011. The Company continues to be challenged by increased fuel prices. U.S. average price of diesel fuel increased 31.3% from approximately $2.94 per gallon to approximately $3.86 per gallon for the quarter ended September 30, 2011 compared to the quarter ended September 30, 2010. Average diesel fuel price increases for the nine month period ended September 30, 2011 compared to the nine months ended September 30, 2010 have increased 30.6%. For the same three month and nine month periods, the Company's net fuel cost per mile has increased 8.4% and 10.5% respectively as the Company is not able to pass through all fuel price increases through fuel surcharge agreements with customers. The Company continues to focus on fuel surcharge pricing, truck idling hours, and fuel purchasing decisions in an effort to lessen the impact of higher fuel costs. At September 30, 2011, 100% of the Company's tractor fleet is equipped with idle management controls. At September 30, 2011, the Company’s tractor fleet had an average age of 1.81 years which is slightly higher than an average age of 1.58 at September 30, 2010. The Company has continued to upgrade its trailer fleet during 2011 taking advantage of a robust

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used trailer market. At September 30, 2011, the Company's trailer fleet had an average age of 4.18 years compared to 6.26 as of September 30, 2010.

The Company continues to focus on growing internally by providing quality service to targeted customers with a high density of freight in the Company’s regional operating areas. In addition to the development of its regional operating centers, the Company has made five acquisitions since 1987. We believe our commitment to quality service allowed the Company to hold its freight rates relatively stable throughout the recent recession, in comparison to our competitors, better positioning the Company for future growth as market capacity continues to tighten. Future growth is dependent upon several factors including the level of economic growth and the related customer demand, the available capacity in the trucking industry, potential acquisition opportunities, and the availability of experienced drivers.

The Company hires only experienced drivers (minimum 1 year of driving experience) with safe driving records. In order to attract and retain experienced drivers who understand the importance of customer service, the Company has sought to solidify its position as an industry leader in driver compensation by increasing driver compensation three out of the last seven years. The Company is the top or is near the top compensation pay per mile to drivers in the markets it operates.

The Company ended the third quarter quarter of 2011 with operating revenues of $132.5 million, including fuel surcharges, net income of $15.4 million, and earnings per share of $0.17 on weighted average outstanding shares of 90.1 million. The Company posted an 81.0% operating ratio (operating expenses as a percentage of operating revenues) for the three months ended September 30, 2011 compared to 77.2% for the same period of 2010 and a 11.6% net margin (net income as a percentage of operating revenues) in the third quarter of 2011 compared to 14.4% in same period of 2010. The Company had total assets of $544.2 million at September 30, 2011. The Company achieved a return on assets of 12.7% and a return on equity of 19.5% over the immediate past four quarters.

The Company’s cash flow from operations for the nine months ended September 30, 2011 of $71.9 million was 18.1% of operating revenues. The Company used $19.4 million in net investing cash flows, mainly due to the purchases of revenue equipment net proceeds from equipment sales, as the Company continues to upgrade its tractor and trailer fleet, offset by calls of auction rate securities. The Company used $32.5 million in financing activities mainly related to repurchases of common stock as well as dividend payments during the nine months ended September 30, 2011. As a result, the Company increased cash and cash equivalents $20.0 million during the nine months ended September 30, 2011. The Company ended the quarter with cash, cash equivalents, and investments of $205.6 million and a debt-free balance sheet.

Results of Operations

The following table sets forth the percentage relationships of expense items to total operating revenue for the periods indicated:

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	Three Months Ended September 30, 2011		2010		Nine Months Ended September 30, 2011		2010	
Operating revenue	100.0	%	100.0	%	100.0	%	100.0	%
Operating expenses:								
Salaries, wages, and benefits	30.9	%	33.5	%	31.4	%	33.9	%
Rent and purchased transportation	1.4		1.8		1.5		2.0	%
Fuel	30.9		24.9		30.8		24.9	%
Operations and maintenance	4.0		4.0		4.2		3.4	%
Operating taxes and license	1.8		1.7		1.7		1.7	%
Insurance and claims	3.0		1.6		2.6		2.8	%
Communications and utilities	0.6		0.7		0.5		0.7	%
Depreciation	11.2		11.9		10.3		12.5	%
Other operating expenses	2.5		3.4		2.5		2.9	%
Gain on disposal of property and equipment	(5.1	)	(6.2	)	(5.6	)	(2.8	)%
	81.0	%	77.2	%	79.9	%	81.9	%
Operating income	19.0	%	22.8	%	20.1	%	18.1	%
Interest income	0.1		0.3		0.2		0.3	%
Income before income taxes	19.1	%	23.1	%	20.2	%	18.4	%
Income taxes	7.5		8.7		6.9		5.7	%
Net income	11.6	%	14.4	%	13.3	%	12.6	%

Three Months Ended September 30, 2011 Compared With the Three Months Ended September 30, 2010

Operating revenue increased $5.3 million (4.2%), to $132.5 million for the three months ended September 30, 2011 from $127.2 million for the three months ended September 30, 2011. The increase in revenue was mainly the result of a $8.7 million (46.2%) increase in fuel surcharge revenue from $18.8 million in 2010 to $27.5 million in 2011. Offsetting this increase was a net decline in line haul revenue of $3.3 million on a decrease in total miles offset by an increase in freight rates. Fuel surcharge revenues represent fuel costs passed on to customers based on customer specific fuel charge recovery rates and billed loaded miles. Fuel surcharge revenues increased mostly as a result of a 31.3% increase in average Department of Energy ("DOE") diesel fuel prices during the third quarter of 2011 compared to the same period of 2010.

Salaries, wages, and benefits decreased $1.7 million (3.9%), to $40.9 million for the three months ended September 30, 2011 from $42.6 million in the 2010 period. The decrease was the net result of a $1.0 million decrease (2.6%) in driver wages, a $0.4 million (35.5%) increase in health insurance, and a $1.2 million (46.9%) decrease in workers' compensation. During the three months ended September 30, 2011, employee drivers accounted for 98% and independent contractors for 2% of the total fleet miles compared to 97% and 3%, respectively, for the same period in 2010. The Company driver wage decrease was mainly the result of a decrease in overall miles driven based on lower freight volumes and drivers comparing the two periods. Health insurance expense decreased $1.2 million due to an overall decrease in frequency and severity of claims incurred. Workers compensation expense increased $0.4 million due to an increase in the severity of claims incurred.

Rent and purchased transportation decreased $0.5 million (21.8%), to $1.8 million for the period ended September 30, 2011 from $2.3 million in the comparable period of 2010. The decrease is mainly attributable to amounts paid to independent contractors. The decrease in amounts paid to independent contractors is attributable to fewer miles driven as a result of less independent contractors driving for the Company.

Fuel increased $9.3 million (29.3%), to $41.0 million for the period ended September 30, 2011 from $31.7 million for the same period of 2010. The increase is mostly the result of increased fuel prices ($10.3 million) which was offset by a ($1.0 million) decrease due to less miles driven. Fuel cost per mile, net of fuel surcharge, increased 8.4% in the 2011 period compared to the same period of 2010. The DOE average diesel price per gallon for the third quarter of 2011 was $3.86 per gallon compared to the same period of 2010 of $2.94 per gallon a 31.3% increase.

Insurance and claims increased $1.9 million (96.7%), to $3.9 million for the period ended September 30, 2011 from $2.0 million in the same period of 2010 due to an increase in the frequency and severity of larger auto liability related claims during the 2011 period compared to 2010 period.

Depreciation decreased $0.2 million (1.6%), to $14.9 million during the three months ended September 30, 2011 from $15.1 million in the same period of 2010. The decrease is mainly attributable to a decrease in average depreciation per tractor due to timing of tractor purchases and the Company's tractor depreciation method. As tractors are depreciated using the declining balance method, depreciation expense declines in years subsequent to the first year after initial purchase. The majority of current tractor fleet were purchased throughout 2009. Therefore each year after the initial purchase, depreciation expense is lower on a per unit basis. Tractors purchased subsequent to January 1, 2009 are being depreciated using the 150% declining balance method and account for approximately 89.3% of the total tractor fleet at September 30, 2011. Tractors purchased prior to January 1, 2009 are depreciated using the 125% declining balance method. The change was the result of the cost of new tractors, current tractor trade values and the expected values in the used equipment market. The decrease in tractor depreciation due to aging of equipment was partially offset by higher depreciation on new tractors placed in service during 2011. Tractor depreciation decreased $1.2 million to $11.4 million in the third quarter of 2011 from $12.6 million in the same period 2010 as a result of the above items. There was an increase of $1.1 million in trailer depreciation in the third quarter of 2011 compared to 2010. The increase in trailer depreciation was the direct result of trailers that had previously been depreciated to salvage value being replace by new trailers. The change in all other depreciation was not significant.

Operating and maintenance expense increased 0.2 million (4.3%), to $5.3 million during the third quarter of 2011 from $5.0 million in 2010. Operating and maintenance costs increased mainly due to increased tire costs of $0.8 million offset by reductions in costs to prepare tractors and trailers for trades/sales mainly due to lower volumes of sale activity of tractors comparing the two periods. The Company also experienced increases in over-the-road repairs mainly due to heightened awareness of maintenance issues under CSA (Compliance, Safety, Accountability) compliance guidelines.

Gain on the disposal of property and equipment decreased $1.2 million, to $6.8 million during the 2011 period from $8.0 million in the same period of 2010. The decrease was the net effect of a decrease in gains on trades and sales of tractor equipment of $2.1 million and an increase in gains on trailer equipment sales of $0.9 million. The decrease in gains on tractors was largely due to the Company selling approximately 73% less units during the quarter ended September 30, 2011 compared to the same period of 2010 due to timing of purchases of new tractors. The increase in gains on trailers was largely due to the Company selling approximately 44% more units during the quarter ended September 30, 2011 compared to the same period of 2010 due to favorable market conditions. The Company has and will continue to use strong pricing of used equipment as an opportunity to upgrade it's tractor and trailer fleet through the remainder of 2011.

Interest income decreased $0.2 million (49.9%), to $0.2 million in the 2011 period from $0.3 million in the 2010 period. The decrease is mainly the result of lower average returns due to the decline in interest rates applicable to short- and long-term investments which persisted throughout 2010 and into 2011. The decrease in the Company's overall return was largely attributable to a larger mix of cash and cash equivalents tied to short-term interest rates from long-term auction rate security investments due to a significant amount of calls received throughout 2010 and during the first six months of 2011.

The Company’s effective tax rate was 39.1% and 37.8% for three months ended September 30, 2011 and 2010, respectively. The increase in the effective tax rate for 2011 is primarily attributable to an increase in effective state income tax rates and a decrease in favorable income tax expense adjustments during the 2011 period compared to the same period of 2010 resulting .

As a result of the foregoing, the Company’s operating ratio (operating expenses as a percentage of operating revenue) was 81.0% during the period ended September 30, 2011 compared with 77.2% during the period ended September 30,

2010. Net income decreased $2.9 million (15.8%), to $15.4 million for the period ended September 30, 2011 from $18.3 million during the compared 2010 period as a result of the net effects discussed above.

Nine Months Ended September 30, 2011 Compared With the Nine Months Ended September 30, 2010

Operating revenue increased $27.1 million (7.3%), to $397.4 million for the nine months ended September 30, 2011 from $370.3 million for the nine months ended September 30, 2010. The increase in revenue was mainly the result of a $26.3 million (47.9%) increase in fuel surcharge revenue from $55.0 million in 2010 to $81.3 million in 2011. Line haul and other revenues increased $0.8 million (0.3%) on a decreased total miles and an increase in freight rates per total mile. Fuel surcharge revenues represent fuel costs passed on to customers based on customer specific fuel charge recovery rates and billed loaded miles. Fuel surcharge revenues increased mostly as a result of a 30.6% increase in average DOE diesel fuel prices during the nine months ended September 30, 2011 compared to the same period of 2010.

Salaries, wages, and benefits decreased $0.6 million (0.5%), to $124.8 million for the nine months ended September 30, 2011 from $125.4 million in the 2010 period. The decrease was the net result of a $1.0 million decrease (1.1%) in driver wages, a $0.6 million increase (4.0%) in office and shop wages, a $1.0 million (14.6%) decrease in health insurance, and a $0.4 million (12.2%)

increase in other benefits and payroll taxes. During the nine months ended September 30, 2011, employee drivers accounted for 98% and independent contractors for 2% of the total fleet miles compared to 97% and 3%, respectively, for the same period in 2010. The Company driver wage decrease was the combined result of a decrease in miles driven and a slight decrease in the overall rate based on changes in driver mix. Office and shop personnel wages increased primarily as a result of more non-driver personnel in 2011 compared to the same period of 2010. Health insurance and workers compensation decreased and increased respectively due to frequency and severity of claims.

Rent and purchased transportation decreased $1.5 million (20.7%), to $5.8 million for the nine month period ended September 30, 2011 from $7.3 million in the comparable period of 2010. The decrease is mainly attributable to amounts paid to independent contractors. The decrease in amounts paid to independent contractors is attributable to fewer miles driven as a result of less independent contractors driving for the Company.

Fuel increased $30.2 million (32.7%), to $122.4 million for the nine month period ended September 30, 2011 from $92.2 million for the same period of 2010. The increase is mostly the result of increased fuel prices ($30.0 million) which was offset by a slight decrease in volume mainly due to less miles driven. Fuel cost per mile, net of fuel surcharge, increased 10.1% in the 2011 period compared to the same period of 2010. The DOE average diesel price per gallon for the nine months ended September 30, 2011 was $3.84 per gallon compared to the same period of 2010 of $2.94 per gallon a 30.6% increase.

Depreciation decreased $5.3 million (11.5%), to $40.9 million during the nine months ended September 30, 2011 from $46.2 million in the same period of 2010. The decrease is mainly attributable to a decrease in average depreciation per tractor due to timing of tractor purchases and the Company's tractor depreciation method. As tractors are depreciated using the declining balance method, depreciation expense declines in years subsequent to the first year after initial purchase. The majority of current tractor fleet were purchased throughout 2009. Therefore each year after the initial purchase, depreciation expense is lower on a per unit basis. Tractors purchased subsequent to January 1, 2009 are being depreciated using the 150% declining balance method and account for approximately 89.3% of the total tractor fleet at September 30, 2011. Tractors purchased prior to January 1, 2009 are depreciated using the 125% declining balance method. The change was the result of the cost of new tractors, current tractor trade values and the expected values in the used equipment market. The decrease in tractor depreciation due to aging of equipment was partially offset by higher depreciation on new tractors placed in service during the first nine months of 2011. Tractor depreciation decreased $6.9 million to $31.5 million for the nine months ended September 30, 2011 from $38.4 million in the same period 2010 as a result of the above items. There was an increase of $1.6 million in trailer depreciation in the nine months ended September 30, 2011 compared to 2010. The increase in trailer depreciation was the direct result of trailers that had previously been depreciated to salvage value being replaced by new trailers. The change in all other depreciation was not significant.

Operating and maintenance expense increased $3.9 million (30.9%), to $16.5 million during the nine months ended September 30, 2011from $12.6 million in 2010. Operating and maintenance costs increased mainly due to increased tire costs, $2.8 million and increased costs to prepare tractors and trailers for trades/sales and certain updates to older trailers within the Company's fleet. The Company also experienced increases in over-the-road repairs mainly due to heightened awareness of maintenance issues under CSA compliance guidelines.

Gains on the disposal of property and equipment increased $11.8 million, to $22.3 million during the nine months ended September 30, 2011 from $10.5 million in the same period of 2010. The increase was the net effect of an increase in gains on trades and sales of tractor equipment of $5.4 million and increased gains on trailer equipment sales of $6.5 million. The increase in gains on tractors and trailers was largely due to the Company selling approximately 9% more tractors and approximately 141% more trailer equipment during the nine months ended September 30, 2011 compared to the same period of 2010 due to favorable market conditions and the Company's fleet upgrade program. The Company has and will continue to use strong pricing of used equipment as an opportunity to upgrade it's tractor and trailer fleet through the remainder of 2011.

Interest income decreased $0.5 million (46.8%), to $0.6 million in the nine months ended September 30, 2011from $1.2 million in the 2010 period.   The decrease is mainly the result of lower average returns due to the decline in interest rates applicable to short- and long-term investments which persisted throughout 2010 and into 2011. The decrease in the Company's overall return was largely attributable to a larger mix of cash and cash equivalents tied to short-term interest rates from long-term auction rate security investments due to a significant amount of calls received throughout 2010 and during the first nine months of 2011.

The Company’s effective tax rate was 34.2% and 31.2% for nine months ended September 30, 2011 and 2010, respectively. The increase in the effective tax rate for 2011 is primarily attributable to a decrease in favorable income tax expense adjustments during the 2011 period compared to the same period of 2010 resulting from the roll off of certain state tax contingencies coupled with more taxable income during the current year compared to the same period of 2010.

As a result of the foregoing, the Company’s operating ratio (operating expenses as a percentage of operating revenue) was 79.9%

during the nine month period ended September 30, 2011 compared with 81.9% during the six month period ended September 30, 2010. Net income increased $6.0 million (12.8%), to $52.8 million for the nine month period ended September 30, 2011 from $46.8 million during the compared 2010 period as a result of the net effects discussed above.

Liquidity and Capital Resources

The growth of the Company's business requires significant investments in new revenue equipment. Historically the Company has been debt-free, funding revenue equipment purchases with cash flow provided by operations, which has been the case during the most recent tractor and trailer upgrades. The Company ended the third quarter of 2011 with cash and cash equivalents of $141.1 million. The Company's primary source of liquidity has historically been from operating activities which during the first nine months of 2011 was $71.9 million compared to $72.9 million during the same period of 2010. This was primarily a result of net income (excluding non-cash depreciation, changes in deferred taxes, and gains on disposal of equipment) being approximately $9.9 million higher in the first nine months of 2011 compared to 2010 offset by a decrease in cash flow generated by operating assets and liabilities of approximately $10.9 million. The net decrease in cash provided by operating assets and liabilities for 2011 compared to the same period of 2010 was mainly attributable to increased spending on prepaid tires and a reduction in accounts payable and accrued expenses due to timing of payments. Cash flow from operating activities was 18.1% of operating revenues in three months ended September 30, 2011 compared with 19.7% for the same period of 2010.

Cash flows from investing decreased $67.7 million for the first nine months of 2011 compared to the same period of 2010 due to net cash usage of $19.4 million during 2011 compared to cash inflows of $48.3 million during 2010. The decrease of investing cash flows was mainly the result of an increase in net capital expenditures of $58.0 million, as the Company continues to upgrade its tractor and trailer fleets with new equipment which was partially offset by sales of tractor and trailer equipment. In addition to the increased use of cash for capital expenditures was a reduction in net cash (investment maturities and calls less purchases) provided by investments of $8.7 million. During 2010 the Company purchased certain investments, $17.4 million, with excess cash whereas in 2011 excess operating cash is being placed in cash equivalents. There was also a reduction of $26.1 million in cash provided by calls of tax free, auction rate student loan educational bonds ("ARS"). The Company currently anticipates capital expenditures on revenue equipment to be approximately $17.0 million for the remainder of 2011, net of proceeds on tractors expected to be sold during the remainder of 2011. Although the Company expects to sell trailers during the remainder of 2011 and into the first quarter of 2012, to provide additional sources of cash flows for new trailers, there were no guaranteed commitments from third parties to buy trailers during 2011 and therefore these estimated trailer proceeds do not reduce the Company's outstanding commitment.

In September, 2001, the Board of Directors of the Company authorized a program to repurchase 15.4 million shares, adjusted for stock splits, of the Company's common stock in open market or negotiated transactions using available cash, cash equivalents and investments. The authorization remains open at September 30, 2011 and has no expiration date. There were 2.2 million shares repurchased in the open market during the three and nine months ended September 30, 2011 for $29.6 million. The repurchased shares were accounted for as treasury stock and are available to be reissued. No shares were repurchased during the three and nine months ended September 30, 2010. The repurchase program may be suspended or discontinued at any time without prior notice. Approximately 4.3 million shares remain authorized for repurchase under the program as of September 30, 2011.

The Company paid income taxes, net of refunds, of $17.2 million in the first nine months of 2011 which was $12.3 million lower than income taxes paid during the same period in 2010 of $29.5 million. The decrease is largely driven by a reduction in estimated federal income tax payments as a result of 100% bonus depreciation on new equipment purchases during 2011.

Management believes the Company has adequate liquidity to meet its current and projected needs. Management believes the Company will continue to have significant capital requirements over the long-term which are expected to be funded from cash flows provided by operations and from existing cash, cash equivalents and investments. The Company's balance sheet remains debt free. At September 30, 2011 the Company had $205.6 million in cash, cash equivalents and investments, a decrease of $4.2 million from December 31, 2010.

All of the Company's short-term and long-term investment balances at September 30, 2011 and at December 31, 2010 were invested in tax free, auction rate student ("ARS") loan educational bonds that are classified as available-for-sale. The investments typically have an interest reset provision of 35 days with contractual maturities that currently range from December 1, 2031 to May 1, 2040. At the reset date, the Company has the option to roll the investments and reset the interest rate or sell the investments in an auction. The Company receives the par value of the investment plus accrued interest on the reset date if the underlying investment is sold. As of September 30, 2011, 100.0% of ARS holdings, at par, were backed by the U.S. government and held AAA (or equivalent) ratings from recognized rating agencies.

As of September 30, 2011, all of the Company's auction rate student loan bonds were associated with unsuccessful auctions. As such, the estimated fair value of the underlying investments had declined below amortized cost of the investments as a result of liquidity issues in the auction rate markets. To date, there have been no instances of delinquencies or non-payment of applicable interest from the issuers and all calls of securities by the issuers have been at par value plus accrued interest. Since the first auction failures in February 2008 when the Company had approximately $198.5 million ARS at par, the Company has received approximately $142.2 million of calls from issuers, at par, plus accrued interest at the time of the call. This includes $2.6 million and $24.2 million received in the three and nine months ended September 30, 2011, respectively, and $11.3 million received subsequent to September 30, 2011. Accrued interest income is included in other current assets in the consolidated balance sheet.

The Company estimates the fair value of the auction rate securities applying the authoritative guidance on fair value measurements which establishes fair value as an estimate of what the Company could sell the investments for in an orderly transaction with a third party as of each measurement date. It is not the intent of the Company to sell such securities at discounted pricing. The authoritative guidance established a three level fair value hierarchy with Level 1 investments deriving fair value from quoted prices in active markets and Level 3 investments deriving fair value from model-based techniques that use significant inputs and assumptions not observable to market participants. Until auction failures began, the fair value of these investments were calculated using Level 1 observable inputs and fair value was deemed to be equivalent to amortized cost due to the short-term and regularly occurring auction process. Based on auction failures beginning in mid-February 2008 and continued failures through September 30, 2011, there were no significant observable quoted prices or other relevant inputs for identical or similar securities. The fair value of these investments as of the September 30, 2011 and 2010 measurement dates could not be determined with precision based on lack of observable market data and could significantly change in future measurement periods.

The Company performs an internal cash flow analysis on an individual investment basis to estimate fair value of ARS using inputs determined based on management's understanding of market conditions as well as information derived from other publicly available third party sources. This approach considers the anticipated estimated outstanding average life of the underlying student loans (range of 2 to 12 years) that are the collateral to the trusts, principal outstanding, expected rates of returns over the average life of the underlying student loans using forward rate curves, and payout formulas. Management also uses notices received of intent to call certain securities before their contractual maturities within the cash flow models. The range of estimated outstanding lives is based on call notices received by the Company, communications with trusts, and communications with third party financial institutions. These underlying cash flows, by individual investment, were discounted using interest rates consistent with instruments of similar quality and duration adjusted for a lack of liquidity in the market. The Company also obtains estimated fair value of ARS from third party financial advisors. The Company obtains an understanding of assumptions in models used by third party financial institutions to estimate fair value. All of this information is considered when determining the estimated fair value of these instruments as recorded in the consolidated financial statements. The Company's discounted cash flow approach requires the use of multiple input factors including an estimated rate of return, base discount rate, and a liquidity discount rate to reflect the current lack of liquidity of ARS in capital markets due to auction failures. We understand that models employed by the Company's third party financial advisors are also subject to changes in similar input factors. As such, the fair value of ARS is subject to change based on significant changes to the underlying input factors. The Company has analyzed the potential impact of a 50 basis point change to the rate of return, discount rate, and liquidity discount rate noting that this would not materially impact the recorded fair value.

The table below shows the inputs in the Company's cash flow models as of September 30, 2011 for the remaining ARS investments compared to the inputs used in cash flow models as of December 31, 2010. Inputs used in Company models of all securities held as of September 30, 2011 and December 31, 2010, excluding investments whose fair value is estimated to be par value as of the reporting period due to call notices being received by the Company were as follows:

	September 30, 2011	December 31, 2010
Average life of underlying loans	2-12 years	2-12 years
Rate of return	0.70-2.62%	1.28-4.12%
Discount rate	0.28%-0.93%	0.53%-1.85%
Liquidity discount rate	0.55%-0.97%	0.40%-0.80%

The unrealized loss of $3.1 million is recorded as an adjustment to accumulated other comprehensive loss and the Company has not recognized any other than temporary impairments in the consolidated statements of income. There were not any realized gains or losses related to these investments for the three and nine month periods ended September 30, 2011 and 2010. The Company can not currently project when liquidity will be obtained from these investments and plans to continue to hold such securities until the securities are called, redeemed, or resecuritized by the debt issuers.

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Off-Balance Sheet Transactions

The Company’s liquidity or financial condition is not materially affected by off-balance sheet transactions.

Risk Factors

You should refer to Item 1A of our Annual Report (Form 10-K) for the year ended December 31, 2010, under the caption “Risk Factors” for specific details on the following factors that are not within the control of the Company and could affect our financial results.

- Our business is subject to general economic and business factors that are largely out of our control, any of which could have a materially adverse effect on our operating results.
- Our growth may not continue at historic rates.
- If we are unable to retain our current customers at our current freight rates, our results of operations could be adversely affected.
- We have significant ongoing capital requirements that could affect our profitability if we are unable to generate sufficient cash from operations and obtain financing on favorable terms.
- Increased prices, reduced productivity, and restricted availability of new revenue equipment and decreased demand and value of used equipment may adversely affect our earnings and cash flows.
- If fuel prices increase significantly, our results of operations could be adversely affected.
- Difficulty in driver and independent contractor recruitment and retention may have a materially adverse effect on our business.
- We operate in a highly regulated industry, and increased costs of compliance with, or liability for violation of, existing or future regulations could have a materially adverse effect on our business.
- CSA (Compliance, Safety, Accountability) could adversely affect our profitability and operations, our ability to maintain or grow our fleet, and our customer relationships.
- Our operations are subject to various environmental laws and regulations, the violations of which could result in substantial fines or penalties.
- We may not make acquisitions in the future, or if we do, we may not be successful in integrating the acquired company, either of which could have a materially adverse effect on our business.
- If we are unable to retain our key employees or find, develop, and retain service center managers, our business, financial condition, and results of operations could be adversely affected.
- We are highly dependent on a few major customers, the loss of one or more of which could have a materially adverse effect on our business.
- If the estimated fair value of auction rate securities continues to remain below cost or if the fair value decreases significantly from the current fair value, we may be required to record an impairment of these investments, through a charge in the consolidated statement of income, which could have a materially adverse effect on our earnings.
- Seasonality and the impact of weather affect our operations profitability.
- Ongoing insurance and claims expenses could significantly reduce our earnings.
- We are dependent on computer and communications systems, and a systems failure could cause a significant disruption to our business.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

General

We are exposed to market risk changes in interest rates on our investments and from changes in commodity prices, primarily fuel and rubber. We do not currently use derivative financial instruments for risk management purposes and do not use them for either speculation or trading. Because our operations are confined to the United States, we are not subject to a material foreign currency risk.

Investments

All of the Company’s short-term and long-term investment balances at September 30, 2011 and at December 31, 2010 were invested in tax free, auction rate student ("ARS") loan educational bonds that are classified as available-for-sale. Should the Company have a need to liquidate any of these investments, the Company may be required to discount these securities for liquidity but the Company currently does not have this liquidity requirement. Based on historical and current operating cash flows, the Company does not currently anticipate a requirement to liquidate underlying investments at discounted prices. If the investments are downgraded in the credit ratings or the Company witnesses other indicators of issues with collection, the Company may be required to recognize an impairment (other than the temporary impairment already recognized) on these securities and record a charge in the statement of income.

Assuming the Company maintains short-term and long-term investment balances consistent with balances as of September 30, 2011, ($67.6 million amortized cost), and if market rates of interest on our investments decreased by 100 basis points, the estimated reduction in annual interest income would be approximately $0.7 million.

Interest Rate Risk

The Company has no debt outstanding as of September 30, 2011 and therefore, has no market risk related to debt. Management believes that an increase in short-term interest rates could have a materially adverse effect on our financial condition only if we incur substantial indebtedness and the interest rate increases are not offset by freight rate increases or other items. Management does not foresee or expect in the near future any significant changes in our exposure to interest rate fluctuations or in how that exposure is managed by us.

Commodity Price Risk

We are subject to commodity price risk primarily with respect to purchases of fuel. Historically, we have sought to recover a portion of our short-term fuel price increases from customers through fuel surcharges. Fuel surcharges that can be collected do not always fully offset an increase in the cost of diesel fuel. We believe that the majority of the fuel price increases are generally passed to our customers although based on the Company's historical experience, the Company is not able to pass through to customers 100% of fuel price increases. The Company is not able to pass through fuel costs associated with out-of-route miles and tractor idle time.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures– The Company has established disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company’s financial reports and to other members of senior management and the Board of Directors.

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer (Principal Executive Officer) and Chief Financial Officer (Principal Accounting and Financial Officer), of the effectiveness of the design and operations of the Company's disclosure controls and procedures, and as defined in Exchange Act Rule 15d-15(e). Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in enabling the Company to record, process, summarize and report information required to be included in the Company's periodic SEC filings within the required time period.

Changes in Internal Control Over Financial Reporting – There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2011, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

The Company is a party to ordinary, routine litigation and administrative proceedings incidental to its business. These proceedings primarily involve claims for personal injury, property damage, cargo, and workers' compensation incurred in connection with the transportation of freight. The Company maintains insurance to cover liabilities arising from the transportation of freight for amounts in excess of certain self-insured retentions.

Item 2. CHANGE IN SECURITIES

Repurchases of common stock

	(a) Total number of shares purchased	(b) Average price paid per share	(c) Total number of shares purchased as part of publicly announced plans or programs	(d) Maximum number of shares that may yet be purchased under the plans or programs
July 1, 2011 - July 31, 2011	—	$—	—	—
August 1, 2011 - August 31, 2011	830,190	$13.19	830,190	5,627,300
September 1, 2011 - September 30, 2011	1,377,040	$13.38	1,377,040	4,250,260

Item 3. DEFAULTS UPON SENIOR SECURITIES

None

Item 4. RESERVED

Item 5. OTHER INFORMATION

None.

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Item 6. EXHIBITS

3.1	Articles of Incorporation. Incorporated by reference to the Company's registration statement on Form S-1, Registration No. 33-8165, effective November 5, 1986.
3.2	Amended and Restated Bylaws. Incorporated by reference to the Company's Form 10-K, for the year ended December 31, 2007, dated February 28, 2008
3.3	Certificate of Amendment to Articles of Incorporation. Incorporated by reference to the Company's Form 10-QA, for the quarter ended June 30, 1997, dated March 20, 1998.
4.1	Articles of Incorporation. Incorporated by reference to the Company's registration statement on Form S-1, Registration No. 33-8165, effective November 5, 1986.
4.2	Amended and Restated Bylaws. Incorporated by reference to the Company's Form 10-K, for the year ended December 31, 2007, dated February 28, 2008.
4.3	Certificate of Amendment to Articles of Incorporation. Incorporated by reference to the Company's Form 10-QA, for the quarter ended June 30, 1997, dated March 20, 1998.
31.1*	Certification of Principal Executive Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
31.2*	Certification of Principal Financial Officer Pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.
32.1*	Certification of Principal Executive Officer Pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Certification of the Principal Financial Officer Pursuant to 18 U.S.C. 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.DEF**	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB**	XBRL Taxonomy Extension Label Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document

*Filed with the Company's Quarterly Report on Form 10-Q for the period ended September 30, 2011, filed with the Securities and Exchange Commission on November 7, 2011.

** In accordance with Regulation S-T, the XBRL-related information in Exhibit 101 shall be deemed to be "furnished" and not "filed."

No other information is required to be filed under Part II of the form.

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SIGNATURE

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

HEARTLAND EXPRESS, INC.

Date: November 7, 2011

BY: /s/ John P. Cosaert
John P. Cosaert
Executive Vice President-Finance,
Chief Financial Officer and Treasurer
(Principal accounting and financial officer)

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