

NICHOLAS FINANCIAL INC

Form 10-Q

November 09, 2011

[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

September 30, 2011 FOR THE QUARTERLY PERIOD ENDED September 30, 2011

.. **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: 0-26680

NICHOLAS FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

British Columbia, Canada
(State or Other Jurisdiction of

8736-3354
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

2454 McMullen Booth Road, Building C

Clearwater, Florida
(Address of Principal Executive Offices)

33759
(Zip Code)

(727) 726-0763

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ Smaller reporting company ☐

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes ☐ No ☒

As of October 28, 2011, the registrant had 11,965,585 shares of common stock outstanding.

Table of Contents

NICHOLAS FINANCIAL, INC.

FORM 10-Q

TABLE OF CONTENTS

	Page
<u>Part I. Financial Information</u>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2011 and as of March 31, 2011</u>	2
<u>Condensed Consolidated Statements of Income for the three and six months ended September 30, 2011 and 2010</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2011 and 2010</u>	4
<u>Notes to the Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	12
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	20
Item 4. <u>Controls and Procedures</u>	20
<u>Part II. Other Information</u>	
Item 1A. <u>Risk Factors</u>	20
Item 6. <u>Exhibits</u>	20

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS**

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2011 (Unaudited)	March 31, 2011
Assets		
Cash	\$ 2,719,693	\$ 2,017,540
Finance receivables, net	236,932,524	230,163,854
Assets held for resale	1,472,982	1,055,140
Income taxes receivable	659,497	
Prepaid expenses and other assets	611,034	680,615
Property and equipment, net	828,169	771,311
Deferred income taxes	9,142,387	8,954,665
Total assets	\$ 252,366,286	\$ 243,643,125
Liabilities and shareholders' equity		
Line of credit	\$ 117,000,000	\$ 118,000,000
Drafts payable	1,393,773	1,878,609
Accounts payable and accrued expenses	6,768,489	7,209,387
Income taxes payable		233,754
Deferred revenues	1,070,846	1,107,907
Total liabilities	126,233,108	128,429,657
Shareholders' equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 11,965,585 and 11,806,660 shares issued and outstanding, respectively	27,631,458	26,337,731
Retained earnings	98,501,720	88,875,737
Total shareholders' equity	126,133,178	115,213,468
Total liabilities and shareholders' equity	\$ 252,366,286	\$ 243,643,125

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Revenue:				
Interest and fee income on finance receivables	\$ 17,199,730	\$ 15,721,876	\$ 33,823,318	\$ 30,664,781
Sales	11,269	9,977	21,986	19,219
	17,210,999	15,731,853	33,845,304	30,684,000
Expenses:				
Cost of sales	2,843	3,411	5,599	6,317
Marketing	304,033	310,423	602,829	629,082
Salaries and employee benefits	4,366,502	3,981,210	8,758,312	7,914,721
Administrative	2,032,748	1,880,234	3,962,131	3,807,240
Provision for credit losses	178,029	1,711,873	257,444	3,307,534
Depreciation	72,996	66,306	145,537	133,399
Interest expense	1,236,893	1,449,757	2,465,871	2,989,130
Change in fair value of interest rate swaps		(137,828)		(382,193)
	8,194,044	9,265,386	16,197,723	18,405,230
Operating income before income taxes	9,016,955	6,466,467	17,647,581	12,278,770
Income tax expense	3,496,851	2,484,123	6,824,684	4,720,588
Net income	\$ 5,520,104	\$ 3,982,344	\$ 10,822,897	\$ 7,558,182
Earnings per share:				
Basic	\$ 0.47	\$ 0.34	\$ 0.92	\$ 0.65
Diluted	\$ 0.46	\$ 0.34	\$ 0.90	\$ 0.64
Dividends declared per share	\$ 0.10		\$ 0.10	

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six months ended	
	September 30,	
	2011	2010
Cash flows from operating activities		
Net income	\$ 10,822,897	\$ 7,558,182
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	145,537	133,399
Gain on sale of property and equipment	(4,026)	(3,648)
Provision for credit losses	257,444	3,307,534
Deferred income taxes	(187,722)	(855,856)
Share-based compensation	234,911	309,140
Change in fair value of interest rate swaps		(382,193)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	69,581	268,100
Accounts payable and accrued expenses	(440,898)	277,667
Income taxes receivable/payable	(893,251)	(300,664)
Deferred revenues	(37,061)	(657)
Net cash provided by operating activities	9,967,412	10,311,004
Cash flows from investing activities		
Purchase and origination of finance contracts	(65,826,689)	(66,741,246)
Principal payments received	58,800,575	46,358,898
Increase in assets held for resale	(417,842)	(275,751)
Purchase of property and equipment	(219,019)	(174,448)
Proceeds from sale of property and equipment	20,650	14,255
Net cash used in investing activities	(7,642,325)	(20,818,292)
Cash flows from financing activities		
Net (repayment) proceeds from line of credit	(1,000,000)	9,725,029
(Decrease) increase in drafts payable	(484,836)	151,580
Payment of cash dividend	(1,196,914)	
Proceeds from exercise of stock options	699,159	49,390
Excess tax benefits from exercise of stock options and issuance of other share awards	359,657	56,060
Net cash (used) provided by financing activities	(1,622,934)	9,982,059
Net increase (decrease) in cash	702,153	(525,229)
Cash, beginning of period	2,017,540	1,533,894
Cash, end of period	\$ 2,719,693	\$ 1,008,665

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2011, which has been derived from audited financial statements, and the accompanying unaudited interim condensed consolidated financial statements of Nicholas Financial, Inc. (including its subsidiaries, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q pursuant to the Securities and Exchange Act of 1934, as amended in Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements, although the Company believes that the disclosures made are adequate to ensure the information is not misleading. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending March 31, 2012. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and accompanying notes thereto included in the Company's Annual Report on Form 10-K for the year ended March 31, 2011 as filed with the Securities and Exchange Commission on June 14, 2011. The March 31, 2011 condensed consolidated balance sheet included herein has been derived from the March 31, 2011 audited consolidated balance sheet included in the aforementioned Form 10-K.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for credit losses on finance receivables, and the net realizable value of assets held for resale.

2. Revenue Recognition

Finance receivables consist of automobile finance installment contracts (Contracts) and direct consumer loans (Direct Loans). Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan is contractually delinquent for 60 days or more or the collateral is repossessed, whichever is earlier.

The amount of future unearned income is computed as the product of the Contract rate, the Contract term, and the Contract amount.

Deferred revenues consist primarily of commissions received from the sale of ancillary products. These products include automobile warranties, roadside assistance programs, accident and health insurance, credit life insurance and forced placed automobile insurance. These commissions are amortized over the life of the contract using the interest method.

The Company's net fees charged for processing a loan are recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method.

The Company attributes its entire dealer discount to a reserve for credit losses. A dealer discount represents the difference between the finance receivable, net of unearned interest of a Contract, and the amount of money the Company actually paid for the Contract. After the analysis of purchase date accounting is complete, any uncollectable amounts would be contemplated in estimating the allowance for loan losses.

Sales relate principally to telephone support agreements and the sale of business forms to small businesses located primarily in the Southeastern United States. The aforementioned sales of the Nicholas Data Services, Inc. subsidiary, (NDS) represent less than 1% of the Company's consolidated revenues.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Earnings Per Share

Basic earnings per share is calculated by dividing the reported net income for the period by the weighted average number of shares of common stock outstanding. Diluted earnings per share includes the effect of dilutive options and other share awards. Basic and diluted earnings per share have been computed as follows:

		Three months ended September 30,		Six months ended September 30,	
		2011	2010	2011	2010
Numerator for earnings per share	net income	\$ 5,520,104	\$ 3,982,344	\$ 10,822,897	\$ 7,558,182
Denominator:					
Denominator for basic earnings per share	weighted average shares	11,772,819	11,607,523	11,709,875	11,606,505
Effect of dilutive securities:					
Stock options and other share awards		254,642	242,556	291,914	236,010
Denominator for diluted earnings per share		12,027,461	11,850,079	12,001,789	11,842,515
Earnings per share:					
Basic		\$ 0.47	\$ 0.34	\$ 0.92	\$ 0.65
Diluted		\$ 0.46	\$ 0.34	\$ 0.90	\$ 0.64

For the three and six months ended September 30, 2011 potential common stock from stock options totaling 55,000 and 72,300, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive. For the three and six months ended September 30, 2010 potential common stock from stock options totaling 124,100 in each period were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

4. Finance Receivables

Finance receivables consist of automobile finance installment Contracts and Direct Loans and are detailed as follows:

	September 30, 2011	March 31, 2011
Finance receivables, gross contract	\$ 383,019,564	\$ 372,950,283
Unearned interest	(109,240,396)	(106,512,562)
Finance receivables, net of unearned interest	273,779,168	266,437,721
Allowance for credit losses	(36,846,644)	(36,273,867)

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Finance receivables, net	\$ 236,932,524	\$ 230,163,854
--------------------------	----------------	----------------

The terms of the finance receivables range from 12 to 72 months and the direct consumer loans range from 6 to 48 months. The receivables bear a weighted average interest rate of approximately 23.5% as of September 30, 2011 and March 31, 2011.

Finance receivables consist of Contracts and Direct Loans, each of which comprises a portfolio segment. Each portfolio segment consists of smaller balance homogeneous loans which are collectively evaluated for impairment.

The following table sets forth a reconciliation of the changes in the allowance for credit losses on Contracts:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	\$ 36,534,432	\$ 32,334,059	\$ 35,895,449	\$ 30,408,578
Discounts acquired on new volume	2,966,280	3,282,702	6,076,091	6,449,499
Current period provision	109,516	1,654,329	108,708	3,255,166
Losses absorbed	(3,777,929)	(3,879,066)	(6,794,563)	(7,254,208)
Recoveries	542,240	558,914	1,105,108	1,138,526
Discounts accreted	(17,873)	(28,207)	(34,127)	(74,830)
Balance at end of period	\$ 36,356,666	\$ 33,922,731	\$ 36,356,666	\$ 33,922,731

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of September 30, 2011, the average model year of vehicles collateralizing the portfolio was a 2005 vehicle. The average loan to value ratio, which expresses the amount of the Contract as a percentage of the average wholesale value of the automobile, is approximately 90%. A dealer discount represents the difference between the finance receivable, net of unearned interest, of a Contract, and the amount of money the Company actually pays for the Contract. The discount negotiated by the Company is a function of the credit quality of the customer, the wholesale value of the vehicle, and competition in any given market. In making decisions regarding the purchase of a particular Contract the Company considers the following factors related to the borrower: place and length of residence; current and prior job status; history in making installment payments for automobiles; current income; and credit history. In addition, the Company examines its prior experience with Contracts purchased from the dealer from which the Company is purchasing the Contract, and the value of the automobile in relation to the purchase price and the term of the Contract. For allowance purposes, the entire amount of discount is related to credit quality and is considered to be part of the credit loss reserve. The Company utilizes a static pool approach to track portfolio performance. A static pool retains an amount equal to 100% of the discount as a reserve for credit losses. Subsequent to the purchase, if the reserve for credit losses is determined to be inadequate for a static pool, then an additional charge to income through the provision is used to maintain adequate reserves based on management's evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, and current economic conditions. Such evaluation, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management's estimate of probable credit losses and other factors that warrant recognition in providing for an adequate allowance for credit losses.

The average dealer discount associated with new volume for the three months ended September 30, 2011 and 2010 was 8.45% and 8.70%, respectively. The average dealer discount associated with new volume for the six months ended September 30, 2011 and 2010 was 8.48% and 8.78%, respectively.

The following table sets forth a reconciliation of the changes in the allowance for credit losses on Direct Loans:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Balance at beginning of period	\$ 447,271	\$ 342,367	\$ 378,418	\$ 382,869
Current period provision	68,513	57,544	148,736	52,368
Losses absorbed	(32,648)	(60,355)	(51,094)	(110,407)
Recoveries	6,842	11,754	13,918	26,480
Balance at end of period	\$ 489,978	\$ 351,310	\$ 489,978	\$ 351,310

Direct Loans are loans originated directly between the Company and the consumer. These loans are typically for amounts ranging from \$1,000 to \$8,000 and are generally secured by a lien on an automobile, watercraft or other permissible tangible personal property. The majority of Direct Loans are originated with current or former customers under the Company's automobile financing program. The typical direct loan represents a significantly better credit risk than our typical Contract due to the customer's historical payment history with the Company. In deciding whether or not to make a loan, the Company considers the individual's credit history, job stability, income and impressions created during a personal interview with a Company loan officer. Additionally, because most of the direct consumer loans made by the Company to date have been made to borrowers under Contracts previously purchased by the Company, the payment history of the borrower under the Contract is a significant factor in making the loan decision. As of September 30, 2011, loans made by the Company pursuant to its direct loan program

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

constituted approximately 1% of the aggregate principal amount of the Company's loan portfolio.

Changes in the allowance for credit losses for both Contracts and Direct Loans were driven by current economic conditions and trends over several reporting periods which are useful in estimating future losses and overall portfolio performance.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

The following table is an assessment of the credit quality by creditworthiness. A performing account is defined as an account that is less than 60 days past due. A non-performing account is defined as an account that is contractually delinquent for 60 days or more and the accrual of interest income is suspended. When an account is 120 days contractually delinquent, the account is written off.

	September 30, 2011		September 30, 2010	
	Contracts	Direct Loans	Contracts	Direct Loans
Non-bankrupt accounts	\$ 376,895,455	\$ 5,721,768	\$ 349,857,565	\$ 5,007,919
Bankrupt accounts	402,341		485,420	
Total	\$ 377,297,796	\$ 5,721,768	\$ 350,342,985	\$ 5,007,919
Performing accounts	\$ 373,068,536	\$ 5,685,981	\$ 346,081,444	\$ 4,952,479
Non-performing accounts	4,229,260	35,787	4,261,541	55,440
Total	\$ 377,297,796	\$ 5,721,768	\$ 350,342,985	\$ 5,007,919

The following tables present certain information regarding the delinquency rates experienced by the Company with respect to Contracts and under its direct consumer loan program:

<u>Contracts</u>	Gross Balance Outstanding	Delinquencies					Total
		30	59 days	60	89 days	90 + days	
September 30, 2011	\$ 377,297,796	\$ 10,934,539		\$ 3,188,022		\$ 1,041,238	\$ 15,163,799
		2.90%		0.84%		0.28%	4.02%
September 30, 2010	\$ 350,342,985	\$ 8,987,387		\$ 3,288,209		\$ 973,332	\$ 13,248,928
		2.56%		0.94%		0.28%	3.78%
<u>Direct Loans</u>	Gross Balance Outstanding	30	59 days	60	89 days	90 + days	Total
September 30, 2011	\$ 5,721,768	\$ 22,229		\$ 20,229		\$ 15,558	\$ 58,016
		0.39%		0.35%		0.27%	1.01%
September 30, 2010	\$ 5,007,919	\$ 59,277		\$ 41,963		\$ 13,477	\$ 114,717
		1.18%		0.84%		0.27%	2.29%

The delinquency percentage for Contracts more than thirty days past due as of September 30, 2011 was 4.02% as compared to 3.78% as of September 30, 2010. The delinquency percentage for Direct Loans more than thirty days past due as of September 30, 2011 was 1.01% as compared to 2.29% as of September 30, 2010.

When the Company receives a payment for a Contract that was contractually delinquent for more than 60 days, the payment is posted to the account. At the time of the payment, the interest that was paid is recorded as income by the Company and the Contract is no longer considered

over 60 days contractually delinquent; therefore, the accruing of interest is resumed.

5. Line of Credit

Prior to September 1, 2011, the Company had a \$140,000,000 line of credit facility expiring on November 30, 2011.

On September 1, 2011, the Company executed a new agreement with its consortium of lenders that increases the size of the line of credit facility (the Line) from \$140,000,000 to \$150,000,000. The pricing of the Line, which expires on November 30, 2013, is 300 basis points above 30-day LIBOR (4.00% at September 30, 2011 and March 31, 2011) with a 1% floor on LIBOR or at the prime rate. Prime rate borrowings are generally less than \$5.0 million. Pricing is the same as it was under the previous facility. Pledged as collateral for this credit facility are all of the assets of the Company. The outstanding amount of the credit facility was approximately \$117,000,000 and \$118,000,000 as of September 30, 2011 and March 31, 2011, respectively. The amount available under the line of credit was approximately \$33,000,000 and \$22,000,000 as of September 30, 2011 and March 31, 2011, respectively.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

5. Line of Credit (continued)

The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends do not require consent in writing by the agent and majority lenders under the new facility as long as the Company is in compliance with a net income covenant. As of September 30, 2011, the Company was in full compliance with all debt covenants.

6. Interest Rate Swap Agreements

As of September 30, 2011 and March 31, 2011, the Company did not have any outstanding interest rate swap agreements. Based on market conditions, the Company may or may not enter into new interest rate swap agreements during the current fiscal year. The swap agreements, in effect, converted a portion of the floating rate debt to a fixed rate, more closely matching the interest rate characteristics of finance receivables.

The following table summarizes the activity in the notional amounts of interest rate swaps:

	Six months ended September 30,	
	2011	2010
Notional amounts at April 1	\$	\$ 50,000,000
New contracts		
Matured contracts		(30,000,000)
Notional amounts at September 30	\$	\$ 20,000,000

These interest rate swaps were previously designated as cash flow hedges. Based on credit market events that transpired in October 2008, the Company made an economic decision to elect the prime rate pricing option available under the Line for the month of October 2008. As a result, the critical terms of the interest rate swaps and hedged interest payments were no longer identical and the Company undesignated its interest rate swaps as cash flow hedges. Consequently, beginning in October 2008 changes in the fair value of interest rate swaps (unrealized gains and losses) were recorded in earnings. Unrealized losses previously recorded in accumulated other comprehensive loss were reclassified into earnings as interest payments on the Line affected earnings over the remaining term of the respective swap agreements. The Company did not use interest rate swaps for speculative purposes.

The locations and amounts of losses recognized in income are as follows:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Periodic change in fair value of interest rate swaps	\$	\$ 228,319	\$	\$ 621,517
Losses reclassified from accumulated other comprehensive loss		(90,491)		(239,324)
		137,828		382,193

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Periodic settlement differentials included in interest expense	(245,755)	(638,111)
--	-----------	-----------

Pre-tax loss recognized in income	\$	\$ (107,927)	\$	\$ (255,918)
-----------------------------------	----	--------------	----	--------------

The Company recorded net realized gains and losses from the swap agreements in the interest expense line item of the consolidated statement of income. The following table summarizes the average variable rates received and average fixed rates paid under the swap agreements.

	Three months ended September 30, 2011		Six months ended September 30, 2011	
Average variable rate received		0.31%		0.30%
Average fixed rate paid		3.86%		3.96%

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements (continued)

The following table reconciles net income with comprehensive income:

	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Net income	\$ 5,520,104	\$ 3,982,344	\$ 10,822,897	\$ 7,558,182
Reclassification adjustment for loss included in net income, net of tax benefit of \$34,640 and \$91,620, respectively.		55,851		147,704
Comprehensive income	\$ 5,520,104	\$ 4,038,195	\$ 10,822,897	\$ 7,705,886

7. Fair Value Disclosures

The Company measures specific assets and liabilities at fair value, which is an exit price, representing 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. When applicable, the Company utilizes market data or assumptions that market participants would use in pricing the asset or liability under a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a recurring basis. The Company does not currently have any assets or liabilities measured at fair value on a recurring basis.

Financial Instruments Not Measured at Fair Value

The Company's financial instruments, consist of cash, finance receivables, accrued interest, line of credit, and accounts payable. For each of these financial instruments the carrying value approximates fair value. The carrying value of cash approximates the fair value due to the nature of these accounts. Finance receivables, net approximates fair value based on the price paid to acquire indirect loans. The price paid reflects competitive market interest rates and purchase discounts for the Company's chosen credit grade in the economic environment. This market is highly liquid as the Company acquires individual loans on a daily basis from dealers. The initial terms of the indirect finance receivables range from 12 to 72 months. The initial terms of the direct finance receivables range from 6 to 48 months. In addition, there have been minimal changes in interest rates and purchase discounts related to these types of loans. If liquidated outside of the normal course of business, the amount received may not be the carrying value. The Line was amended within the quarter ended September 30, 2011. Based on current market conditions, any new or renewed credit facility would contain pricing that approximates the Company's current Line. Based on these market conditions, the fair value of the Line as of September 30, 2011 was estimated to be equal to the book value. Accrued interest is paid monthly. As a result of the short-term nature of this activity, the carrying value of the accrued interest approximates fair value. The interest rate for the line of credit is a variable rate based on LIBOR pricing options or at the prime rate.

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a nonrecurring basis. The Company does not currently have any assets or liabilities measured at fair value on a nonrecurring basis.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

8. Recently Issued Accounting Standards

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-02: Receivables (Topic 310) A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring in April 2011. The ASU's main objective is to provide greater transparency regarding whether additional guidance or clarification is needed to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The guidance is effective for interim and annual periods beginning on or after June 15, 2011. The guidance did not have an impact on the Company's consolidated financial statements.

The FASB issued ASU 2011-05: Comprehensive Income (Topic 220) Presentation of Comprehensive Income in June 2011. The ASU's main objective is to show the components of comprehensive income to provide a better understanding of the entity's activities. The guidance is effective for interim and annual periods beginning after December 15, 2011. Other than financial statement display, the update will have no impact on the reported amounts in the Company's consolidated financial statements.

9. Cash Dividend

On August 30, 2011, the Company's Board of Directors announced a quarterly cash dividend of \$.10 per share of common stock paid on September 20, 2011.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS **Forward-Looking Information**

This report on Form 10-Q contains various statements, other than those concerning historical information, that are based on management's beliefs and assumptions, as well as information currently available to management, and should be considered forward-looking statements. This notice is intended to take advantage of the safe harbor provided by the Private Securities Litigation Reform Act of 1995 with respect to such forward-looking statements. When used in this document, the words "anticipate," "estimate," "expect," and similar expressions are intended to identify forward-looking statements. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Such statements are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or expected. Among the key factors that may have a direct bearing on the Company's operating results are fluctuations in the economy, the ability to access bank financing, the degree and nature of competition, demand for consumer financing in the markets served by the Company, the Company's products and services, increases in the default rates experienced on Contracts, adverse regulatory changes in the Company's existing and future markets, the Company's ability to expand its business, including its ability to complete acquisitions and integrate the operations of acquired businesses, to recruit and retain qualified employees, to expand into new markets and to maintain profit margins in the face of increased pricing competition. All forward looking statements included in this report are based on information available to the Company on the date hereof, and the Company assumes no obligations to update any such forward looking statement. You should also consult factors described from time to time in the Company's filings made with the Securities and Exchange Commission, including its reports on Forms 10-K, 10-Q, 8-K and annual reports to shareholders.

Critical Accounting Policy

The Company's critical accounting policy relates to the allowance for credit losses. It is based on management's opinion of an amount that is adequate to absorb losses in the existing portfolio. The allowance for credit losses is established through allocations of dealer discount and a provision for losses based on management's evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, and current economic conditions. Such evaluation, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management's estimate of probable credit losses and other factors that warrant recognition in providing for an adequate credit loss allowance.

Because of the nature of the customers under the Company's Contracts and its direct loan program, the Company considers the establishment of adequate reserves for credit losses to be imperative. The Company segregates its Contracts into static pools for purposes of establishing reserves for losses. All Contracts purchased by a branch during a fiscal quarter comprise a static pool. The Company pools Contracts according to branch location because the branches purchase Contracts in different geographic markets. This method of pooling by branch and quarter allows the Company to evaluate the different markets where the branches operate. The pools also allow the Company to evaluate the different levels of customer income, stability, credit history, and the types of vehicles purchased in each market. Each such static pool consists of the Contracts purchased by a branch office during the fiscal quarter.

Contracts are purchased from many different dealers and are all purchased on an individual Contract by Contract basis. Individual Contract pricing is determined by the automobile dealerships and is generally the lesser of state maximum interest rates or the maximum interest rate the customer will accept. In certain markets, competitive forces will drive down Contract rates from the maximum rate to a level where an individual competitor is willing to buy an individual Contract. The Company only buys Contracts on an individual basis and never purchases Contracts in batches, although the Company may consider portfolio acquisitions as part of its growth strategy.

The Company has detailed underwriting guidelines it utilizes to determine which Contracts to purchase. These guidelines are specific and are designed to cause all of the Contracts that the Company purchases to have common risk characteristics. The Company utilizes its District Managers to evaluate their respective branch locations for adherence to these underwriting guidelines. The Company also utilizes an internal audit department to assure adherence to its underwriting guidelines. The Company utilizes the branch model, which allows for Contract purchasing to be done on the branch level. Each Branch Manager may interpret the guidelines differently, and as a result, the common risk characteristics tend to be the same on an individual branch level but not necessarily compared to another branch.

Table of Contents

A dealer discount represents the difference between the finance receivable, net of unearned interest, of a Contract, and the amount of money the Company actually pays for the Contract. The discount negotiated by the Company is a function of the credit quality of the customer, the wholesale value of the vehicle, and competition in any given market. The automotive dealer accepts these terms by executing a dealer agreement with the Company. For allowance purposes, the Company considers the entire amount of discount to be related to credit quality and is part of the credit loss reserve. The Company utilizes a static pool approach to track portfolio performance. A static pool retains an amount equal to 100% of the discount as a reserve for credit losses.

Subsequent to the purchase, if the reserve for credit losses is determined to be inadequate for a static pool which is not fully liquidated, then an additional charge to income through the provision is used to reestablish adequate reserves. If a static pool is fully liquidated and has any remaining reserves, the excess discounts are immediately recognized into income and the excess provision is immediately reversed during the period. For static pools not fully liquidated that are determined to have excess discounts, such excess amounts are accreted into income over the remaining life of the static pool. For static pools not fully liquidated that are deemed to have excess reserves, such excess amounts are reversed against provision for credit losses during the period.

In analyzing a static pool, the Company considers the performance of prior static pools originated by the branch office, the performance of prior Contracts purchased from the dealers whose Contracts are included in the current static pool, the credit rating of the customers under the Contracts in the static pool, and current market and economic conditions. Each static pool is analyzed monthly to determine if the loss reserves are adequate and adjustments are made if they are determined to be necessary.

Introduction

Consolidated net income increased 38% to approximately \$5.5 million for the three-month period ended September 30, 2011 as compared to \$4.0 million for the corresponding period ended September 30, 2010. Diluted earnings per share increased 35% to \$0.46 for the three months ended September 30, 2011 as compared to \$0.34 for the three months ended September 30, 2010. Consolidated net income increased to approximately \$10.8 million for the six-month period ended September 30, 2011 as compared to \$7.6 million for the corresponding period ended September 30, 2010. Diluted earnings per share increased 42% to \$0.90 for the six months ended September 30, 2011 as compared to \$0.64 for the six months ended September 30, 2010.

Earnings were favorably impacted primarily by an increase in average finance receivables, a decrease in operating expenses as a percentage of average finance receivables, net of unearned interest, and a decrease in the net charge off percentage and a reduction in the provision for credit losses. The Company's software subsidiary, Nicholas Data Services, did not contribute significantly to consolidated operations in the three or six months ended September 30, 2011 or 2010.

Table of Contents

Portfolio Summary	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Average finance receivables, net of unearned interest (1)	\$ 272,906,536	\$ 249,065,668	\$ 271,022,679	\$ 243,690,043
Average indebtedness (2)	\$ 116,505,921	\$ 113,324,542	\$ 117,002,960	\$ 110,785,451
Interest and fee income on finance receivables (3)	\$ 17,199,730	\$ 15,721,876	\$ 33,823,318	\$ 30,664,781
Interest expense	1,236,893	1,449,757	2,465,871	2,989,130
Net interest and fee income on finance receivables	\$ 15,962,837	\$ 14,272,119	\$ 31,357,447	\$ 27,675,651
Weighted average contractual rate (4)	23.94%	23.56%	23.91%	23.55%
Average cost of borrowed funds (2)	4.25%	5.12%	4.22%	5.40%
Gross portfolio yield (5)	25.21%	25.25%	24.96%	25.17%
Interest expense as a percentage of average finance receivables, net of unearned interest	1.81%	2.33%	1.82%	2.45%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	0.26%	2.75%	0.19%	2.71%
Net portfolio yield (5)	23.14%	20.17%	22.95%	20.01%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	9.85%	9.93%	9.85%	10.15%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	13.29%	10.24%	13.10%	9.86%
Write-off to liquidation (8)	5.93%	7.18%	5.34%	6.85%
Net charge-off percentage (9)	4.74%	5.31%	4.18%	4.96%

Note: All three and six month key performance indicators expressed as percentages have been annualized.

- (1) Average finance receivables, net of unearned interest, represents the average of gross finance receivables, less unearned interest throughout the period.
- (2) Average indebtedness represents the average outstanding borrowings under the Line. Average cost of borrowed funds represents interest expense as a percentage of average indebtedness.
- (3) Interest and fee income on finance receivables does not include revenue generated by Nicholas Data Services, Inc., (NDS) the wholly-owned software subsidiary of Nicholas Financial, Inc.

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

- (4) Weighted average contractual rate represents the weighted average annual percentage rate (APR) of all Contracts purchased and Direct Loans originated during the period.
- (5) Gross portfolio yield represents finance revenues as a percentage of average finance receivables, net of unearned interest. Net portfolio yield represents finance revenue minus (a) interest expense and (b) the provision for credit losses as a percentage of average finance receivables, net of unearned interest.
- (6) Administrative expenses included in the calculation above are net of administrative expenses associated with NDS which approximated \$56,000 and \$53,000 during the three-month periods ended September 30, 2011 and 2010 and \$116,000 and \$111,000 during the six-month periods ended September 30, 2011 and 2010, respectively.
- (7) Pre-tax yield represents net portfolio yield minus operating expenses as a percentage of average finance receivables, net of unearned interest.
- (8) Write-off to liquidation percentage is defined as net charge-offs divided by liquidation. Liquidation is defined as beginning receivable balance plus current period purchases minus voids and refinances minus ending receivable balance.
- (9) Net charge-off percentage represents net charge-offs divided by average finance receivables, net of unearned interest, outstanding during the period.

Table of Contents**Three months ended September 30, 2011 compared to three months September 30, 2010****Interest Income and Loan Portfolio**

Interest and fee income on finance receivables, predominately finance charge income, increased 10% to approximately \$17.2 million for the three-month period ended September 30, 2011 from \$15.7 million for the corresponding period ended September 30, 2010. Average finance receivables, net of unearned interest equaled approximately \$272.9 million for the three-month period ended September 30, 2011, an increase of 10% from \$249.1 million for the corresponding period ended September 30, 2010. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and also the opening of new branch locations (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 8% to approximately \$383.0 million as of September 30, 2011, from \$355.4 million as of September 30, 2010. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 25.21% for the three-month period ended September 30, 2011 from 25.25% for the three-month period ended September 30, 2010. The net portfolio yield increased to 23.14% for the corresponding period ended September 30, 2011 from 20.17% for the three-month period ended September 30, 2010. The gross portfolio yield remained relatively flat primarily due to an unchanged weighted APR earned on finance receivables. The net portfolio yield increased primarily due to a decrease in the actual and expected net charge-offs and a corresponding decrease in the provision for credit losses which are discussed below in Analysis of Credit Losses.

Marketing, Salaries, Employee Benefits, Depreciation, and Administrative Expenses

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately \$6.7 million for the three-month period ended September 30, 2011 from approximately \$6.2 million for the corresponding period ended September 30, 2010. The increase of 8% was primarily attributable to salaries expense. The Company opened additional branches and increased average headcount to 288 for the three-month period ended September 30, 2011 from 272 for the three-month period ended September 30, 2010. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 9.85% for the three-month period ended September 30, 2011 from 9.93% for the three-month period ended September 30, 2010.

Interest Expense

Interest expense decreased to approximately \$1.2 million for the three-month period ended September 30, 2011 from \$1.4 million for the three-month period ended September 30, 2010. All interest rate swaps agreements matured during fiscal 2011 and no new agreements were entered into. The following table summarizes the Company's average cost of borrowed funds:

	Three months ended September 30,	
	2011	2010
Variable interest under the line of credit facility	0.47%	0.57%
Settlements under interest rate swap agreements	0.00%	0.87%
Credit spread under the line of credit facility	3.78%	3.68%
Average cost of borrowed funds	4.25%	5.12%

The primary reason that the Company's average cost of funds decreased is attributed to the costs associated with settlements under interest rate swap agreements during the three months ended September 30, 2010.

The weighted average notional amount of interest rate swaps was \$27.2 million at a weighted average fixed rate of 3.86% for the three months ended September 30, 2010. For further discussions regarding the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements.

Table of Contents**Six months ended September 30, 2011 compared to six months ended September 30, 2010****Interest Income and Loan Portfolio**

Interest and fee income on finance receivables, predominately finance charge income, increased 10% to approximately \$33.8 million for the six-month period ended September 30, 2011 from \$30.7 million for the corresponding period ended September 30, 2010. Average finance receivables, net of unearned interest equaled approximately \$271.0 million for the six-month period ended September 30, 2011, an increase of 11% from \$243.7 million for the corresponding period ended September 30, 2010. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and also the opening of new branch locations (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 8% to approximately \$383.0 million as of September 30, 2011, from \$355.4 million as of September 30, 2010. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 24.96% for the six-month period ended September 30, 2011 from 25.17% for the six-month period ended September 30, 2010. The net portfolio yield increased to 22.95% for the corresponding period ended September 30, 2011 from 20.01% for the six-month period ended September 30, 2010. The gross portfolio yield decreased primarily due to a slight decrease in the weighted APR earned on finance receivables. The net portfolio yield increased primarily due to a decrease in the actual and expected net charge-offs and a corresponding decrease in the provision for credit losses.

Marketing, Salaries, Employee Benefits, Depreciation, and Administrative Expenses

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately \$13.5 million for the six-month period ended September 30, 2011 from approximately \$12.5 million for the corresponding period ended September 30, 2010. The increase of 8% was primarily attributable to salaries expense. The Company opened additional branches and increased headcount to 293 for the three-month period ended September 30, 2011 from 272 for the three-month period ended September 30, 2010. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 9.85% for the six-month period ended September 30, 2011 from 10.15% for the six-month period ended September 30, 2010.

Interest Expense

Interest expense decreased to approximately \$2.5 million for the six-month period ended September 30, 2011 from \$3.0 million for the six-month period ended September 30, 2010. The following table summarizes the Company's average cost of borrowed funds for the six-month period ended September 30:

	Six months ended September 30,	
	2011	2010
Variable interest under the line of credit facility	0.44%	0.55%
Settlements under interest rate swap agreements	0.00%	1.15%
Credit spread under the line of credit facility	3.78%	3.70%
 Average cost of borrowed funds	 4.22%	 5.40%

The primary reason that the Company's average cost of funds decreased is attributed to the costs associated with settlements under interest rate swap agreements during the six months ended September 30, 2010.

The weighted average notional amount of interest rate swaps was \$36.2 million at a weighted average fixed rate of 3.96% for the six months ended September 30, 2010. For further discussions regarding the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements.

Table of Contents**Contract Procurement**

The Company purchases Contracts in the fifteen states listed in the table below. The Contracts purchased by the Company are predominately for used vehicles; for the three-month and six-month periods ended September 30, 2011 and 2010, less than 2% were for new vehicles.

The following tables present selected information on Contracts purchased by the Company, net of unearned interest.

State	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
FL	\$ 10,621,214	\$ 12,176,123	\$ 22,032,974	\$ 24,401,790
GA	3,614,109	4,782,217	7,899,035	8,811,638
NC	3,139,984	3,971,706	6,728,124	7,318,021
SC	561,702	507,943	1,291,773	997,803
OH	4,652,242	5,381,608	9,258,582	10,429,292
MI	1,563,293	1,395,616	3,095,815	2,834,109
VA	734,582	1,233,552	1,613,656	2,652,687
IN	2,541,495	2,482,458	4,492,023	4,727,425
KY	2,170,369	2,378,840	4,454,972	4,828,135
MD	314,824	430,883	740,466	888,501
AL	1,793,660	1,535,109	3,436,001	2,830,705
TN	1,326,270	1,478,861	2,439,813	2,760,612
IL	856,456		1,656,376	
MO	1,081,322		2,182,535	
KS	121,967		233,784	
Total	\$ 35,093,489	\$ 37,754,916	\$ 71,555,929	\$ 73,480,718

Contracts	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Purchases	\$ 35,093,489	\$ 37,754,916	\$ 71,555,929	\$ 73,480,718
Weighted APR	23.83%	23.46%	23.80%	23.45%
Average discount	8.45%	8.70%	8.48%	8.78%
Weighted average term (months)	49	49	49	49
Average loan	\$ 9,922	\$ 9,860	\$ 9,900	\$ 9,880
Number of Contracts	3,537	3,829	7,228	7,437

Loan Origination

The following table presents selected information on Direct Loans originated by the Company, net of unearned interest.

Direct Loans Originated	Three months ended September 30,		Six months ended September 30,	
	2011	2010	2011	2010
Originations	\$ 1,634,237	\$ 1,251,446	\$ 2,948,003	\$ 2,413,327
Weighted APR	26.36%	26.66%	26.57%	26.59%
Weighted average term (months)	26	24	25	24
Average loan	\$ 3,043	\$ 2,838	\$ 2,954	\$ 2,813
Number of loans	537	441	998	858

Table of Contents

Analysis of Credit Losses

As of September 30, 2011, the Company had 1,222 active static pools. The average pool upon inception consisted of 61 Contracts with aggregate finance receivables, net of unearned interest, of approximately \$598,000.

The Company anticipates losses absorbed as a percentage of liquidation will be in the 5%-8% range during the remainder of the current fiscal year; however, no assurances can be given that the actual losses absorbed may not be higher as a result of further economic weakness. The longer-term outlook for portfolio performance will depend on the overall economic conditions, the unemployment rate, and the price of oil which impacts the cost of gasoline, food and many other items used or consumed by the average person. Also, the Company's ability to monitor, manage and implement its underwriting philosophy in additional geographic areas as it strives to continue its expansion will impact future portfolio performance. The Company does not believe there have been any significant changes in loan concentrations or terms of Contracts purchased during the three and six months ended September 30, 2011.

The provision for credit losses decreased in each period, largely due to the decrease in the net charge-off rate. The net charge-off rate was 4.74% for the three months ended September 30, 2011 as compared to 5.31% for the three months ended September 30, 2010. The net charge-off rate was 4.18% for the six months ended September 30, 2011 as compared to 4.96% for the six months ended September 30, 2010. Also, the Company has experienced favorable variances between projected write offs and actual write-offs on certain pools which has resulted in an increase in expected future cash flows. This resulted in the reversal of provision on certain seasoned static pools which offset the provision on other static pools. As a result, the provision for credit losses was less than write offs during the current period.

In accordance with our policies and procedures, certain borrowers qualify for, and the Company offers, one-month principal payment deferrals on Contracts. For the three months ended September 30, 2011 and September 30, 2010 the Company granted deferrals to approximately 6.71% and 7.96%, respectively, of total Contracts. For the six months ended September 30, 2011 and September 30, 2010 the Company granted deferrals to approximately 12.47% and 13.78%, respectively, of total Contracts. The number of deferrals is influenced by portfolio performance, general economic conditions and the unemployment rate.

The Company's losses as a percentage of liquidation decreased to 5.93% from 7.18% for the three months ended September 30, 2011 and 2010, respectively. The Company's losses as a percentage of liquidation decreased to 5.34% from 6.85% for the six months ended September 30, 2011 and 2010, respectively. The Company has seen improvements in the performance of its Contracts. The Company has also experienced reduced losses in part due to an increase in auction proceeds from repossessed vehicles. These proceeds are dependent upon several variables including the general market for repossessed vehicles. During the three months ended September 30, 2011 and 2010 auction proceeds from the sale of repossessed vehicles averaged approximately 57% and 50%, respectively of the related principal balance. During the six months ended September 30, 2011 and 2010 auction proceeds from the sale of repossessed vehicles averaged approximately 58% and 50%, respectively of the related principal balance.

Recoveries as a percentage of charge-offs decreased to approximately 15.22% for the three months ended September 30, 2011 from approximately 16.05% for the three months ended September 30, 2010. Recoveries as a percentage of charge-offs decreased to approximately 17.23% for the six months ended September 30, 2011 from approximately 17.94%. Historically, recoveries as a percentage of charge-offs fluctuate from period to period, and the Company does not attribute this decrease to any particular change in operational strategy or economic event.

The Company believes delinquency trends over several reporting periods are useful in estimating future losses and overall portfolio performance. The Company also estimates future portfolio performance by considering various factors, the most significant of which are described as follows. The Company analyzes historical static pool performance for each branch location when determining appropriate reserve levels. Additionally, the Company utilizes results from internal branch audits as an indicator of future static pool performance. The Company also considers such things as the current unemployment rate in markets the Company operates in, the percentage of voluntary repossessions as compared to prior periods, the percentage of bankruptcy filings as compared to prior periods and other leading economic indicators. See note 4 Finance Receivables for changes in allowance for credit losses, credit quality and delinquencies.

Income Taxes

Driven by increases in operating income, the provision for income taxes increased to approximately \$3.5 million for the three months ended September 30, 2011 from approximately \$2.5 million for the three months ended September 30, 2010. The provision for income taxes increased to approximately \$6.8 million for the six months ended September 30, 2011 from approximately \$4.7 million for the six months ended September 30, 2010. The Company's effective tax rate remained consistent increasing slightly to 38.78% for the three months ended September 30, 2011 from 38.45% for the three months ended September 30, 2010. The Company's effective tax rate remained consistent

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

increasing slightly to 38.67% for the six months ended September 30, 2011 from 38.45% for the six months ended September 30, 2010.

Table of Contents**Liquidity and Capital Resources**

The Company's cash flows are summarized as follows:

	Six months ended September 30,	
	2011	2010
Cash provided by (used in):		
Operating activities	\$ 9,967,412	\$ 10,311,004
Investing activities (primarily purchase of Contracts)	(7,642,325)	(20,818,292)
Financing activities	(1,622,934)	9,982,059
Net increase (decrease) in cash	\$ 702,153	\$ (525,229)

The Company's primary use of working capital during the six months ended September 30, 2011 was the funding of the purchase of Contracts which are financed substantially through borrowings under the Company's Line. On September 1, 2011, the Company increased the size of the Line and extended the maturity date to November 30, 2013. The Line is secured by all of the assets of the Company. The Company may borrow up to \$150.0 million. Borrowings under the Line may be under various LIBOR pricing options plus 300 basis points with a 1% floor on LIBOR or at the prime rate. Prime rate based borrowings are generally less than \$5.0 million. As of September 30, 2011, the amount outstanding under the Line was approximately \$117.0 million, and the amount available under the Line was approximately \$33.0 million.

The Company will continue to depend on the availability of the Line, together with cash from operations, to finance future operations. Amounts outstanding under the Line have decreased by approximately \$1.0 million during the six months ended September 30, 2011. The decrease of the Line is principally related to the fact that cash received from operations exceeded cash needed to fund new contracts. The amount of debt the Company incurs from time to time under these financing mechanisms depends on the Company's need for cash and ability to borrow under the terms of the Line. The Company believes that borrowings available under the Line as well as cash flow from operations will be sufficient to meet its short-term funding needs.

The Line requires compliance with certain debt covenants including financial ratios, asset quality and other performance tests. The Company is currently in compliance with all of its debt covenants but, during the current economic slowdown, a breach of one or more of these covenants could occur prior to the maturity date of the Line, which is November 30, 2013. The Company's consortium of lenders could place the Company in default if certain covenants were breached and take one or more of the following actions: increase the Company's borrowing costs; restrict the Company's ability to obtain additional borrowings under the Line; accelerate all amounts outstanding under the Line; or enforce its interests against collateral securing the Line. The Company believes its lenders will continue to allow it to operate in the event of a condition of default; however no assurance can be given that this would occur.

On August 30, 2011, the Company's Board of Directors announced a quarterly cash dividend of \$.10 per share of common stock paid on September 20, 2011. The Company intends to continue to pay quarterly cash dividends for the foreseeable future, provided its future earnings meet expectations. Any payment of future cash dividends and the amounts thereof will be dependent upon the Company's earnings, financial requirements, requirements of its lenders and other factors deemed relevant by the Company's Board of Directors.

Contractual Obligations

The following table summarizes the Company's material obligations as of September 30, 2011.

		Payments Due by Period			
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Operating leases	\$ 2,752,650	\$ 1,524,943	\$ 1,145,405	\$ 82,302	\$
Line of credit	117,000,000		117,000,000		
Interest on line of credit ¹	9,530,625	4,972,500	4,558,125		

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Total	\$ 129,283,275	\$ 6,497,443	\$ 122,703,530	\$ 82,302	\$
-------	----------------	--------------	----------------	-----------	----

¹ Interest on outstanding borrowings under the Line as of September 30, 2011 is based on an effective interest rate of 4.25% and the Company's current credit line, which matures on November 30, 2013. The effective interest rate used in the above table does not contemplate the possibility of entering into interest rate swap agreements in the future.

Table of Contents

Future Expansion

The Company currently operates a total of fifty-eight branch locations in fourteen states, including nineteen in Florida; seven in Ohio; six in North Carolina and Georgia; three in Kentucky, Indiana and Alabama; two in Virginia, Michigan, Tennessee and South Carolina; and one each in Maryland, Illinois, and Missouri. Each office is budgeted (size of branch, number of employees and location) to handle up to 1,000 accounts and up to \$7.5 million in gross finance receivables. To date, fourteen of our branches meet this capacity. The Company continues to evaluate additional markets for future branch locations, and subject to market conditions, would expect to open additional branch locations during fiscal 2012. The Company remains open to acquisitions should an opportunity present itself.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to the Company's operations result primarily from changes in interest rates. The Company does not engage in speculative or leveraged transactions, nor does it hold or issue financial instruments for trading purposes.

Interest rate risk

Management's objective is to minimize the cost of borrowing through an appropriate mix of fixed and floating rate debt. Derivative financial instruments, such as interest rate swap agreements, may be used for the purpose of managing fluctuating interest rate exposures that exist from ongoing business operations. The Company does not use interest rate swaps for speculative purposes.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company's management evaluated, with the participation of the Company's President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of the date of such evaluation to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in internal controls. There have been no changes in the Company's internal control over financial reporting that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended March 31, 2011, which could materially affect our business, financial condition or future results. The risks described in the Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 6. EXHIBITS

See exhibit index following the signature page.

Table of Contents

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.

NICHOLAS FINANCIAL, INC.

(Registrant)

Date: November 9, 2011

/s/ Peter L. Vosotas
Peter L. Vosotas

Chairman of the Board, President,

Chief Executive Officer and Director

Date: November 9, 2011

/s/ Ralph T. Finkenbrink
Ralph T. Finkenbrink

Senior Vice President,

Chief Financial Officer and Director

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
10.1.1	Amendment No. 1 to Second Amended and Restated Loan and Security Agreement, dated September 1, 2011.
10.9	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements
31.1	Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. § 1350
32.2*	Certification of the Chief Financial Officer Pursuant to 18 U.S.C. § 1350
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB**	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document

*This certification accompanies the Quarterly Report on Form 10-Q and is not filed as part of it.

**Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.