

NICHOLAS FINANCIAL INC  
Form 10-Q  
November 13, 2009  
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**

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2009**

.. **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 31, 2009, the registrant had 11,553,114 shares of common stock outstanding.

**Table of Contents**

**NICHOLAS FINANCIAL, INC.**

**FORM 10-Q**

**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>Part I. Financial Information</u></b>	
Item 1. <u>Financial Statements (Unaudited)</u>	
<u>Condensed Consolidated Balance Sheets as of September 30, 2009 and as of March 31, 2009</u>	2
<u>Condensed Consolidated Statements of Income for the three and six months ended September 30, 2009 and 2008</u>	3
<u>Condensed Consolidated Statements of Cash Flows for the six months ended September 30, 2009 and 2008</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>	11
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	21
Item 4. <u>Controls and Procedures</u>	21
<b><u>Part II. Other Information</u></b>	
Item 1A. <u>Risk Factors</u>	21
Item 6. <u>Exhibits</u>	21

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Nicholas Financial, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets**

	September 30, 2009 (Unaudited)	March 31, 2009
<b>Assets</b>		
Cash	\$ 1,868,004	\$ 1,732,575
Finance receivables, net	197,166,298	186,694,369
Assets held for resale	1,446,327	1,058,481
Prepaid expenses and other assets	687,392	717,131
Property and equipment, net	666,808	774,472
Deferred income taxes	7,332,923	6,805,147
Total assets	\$ 209,167,752	\$ 197,782,175
<b>Liabilities</b>		
Line of credit	\$ 109,676,392	\$ 102,030,195
Drafts payable	962,842	975,240
Accounts payable and accrued expenses	5,382,169	5,553,680
Income taxes payable	11,146	206,451
Deferred revenues	1,193,319	1,244,136
Interest rate swaps	1,637,412	2,754,760
Total liabilities	118,863,280	112,764,462
<b>Shareholders' equity</b>		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 11,553,114 and 11,411,214 shares issued and outstanding, respectively (adjusted for stock dividend)	18,303,440	18,073,622
Accumulated other comprehensive loss	(394,879)	(755,919)
Retained earnings	72,395,911	67,700,010
Total shareholders' equity	90,304,472	85,017,713
Total liabilities and shareholders' equity	\$ 209,167,752	\$ 197,782,175

*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,	
	2009	2008	2009	2008
<b>Revenue:</b>				
Interest and fee income on finance receivables	\$ 14,138,708	\$ 13,487,161	\$ 27,811,980	\$ 26,591,127
Sales	19,012	18,196	39,454	33,294
	14,157,720	13,505,357	27,851,434	26,624,421
<b>Expenses:</b>				
Cost of sales	1,601	5,203	5,972	9,431
Marketing	308,097	338,803	620,248	675,438
Salaries and employee benefits	3,559,987	3,384,852	7,022,094	6,834,655
Administrative	1,970,190	1,771,533	3,822,613	3,741,675
Provision for credit losses	3,253,959	5,144,950	6,576,915	8,547,404
Depreciation	81,486	91,232	165,103	179,504
Interest expense	1,293,561	1,431,677	2,566,238	2,841,013
Change in fair value of interest rate swaps	(235,078)		(532,382)	
	10,233,803	12,168,250	20,246,801	22,829,120
Operating income before income taxes	3,923,917	1,337,107	7,604,633	3,795,301
Income tax expense	1,491,915	545,264	2,908,732	1,445,765
Net income	\$ 2,432,002	\$ 791,843	\$ 4,695,901	\$ 2,349,536
<b>Earnings per share:</b>				
Basic (adjusted for stock dividend)	\$ 0.21	\$ 0.07	\$ 0.41	\$ 0.21
Diluted (adjusted for stock dividend)	\$ 0.21	\$ 0.07	\$ 0.40	\$ 0.21

*See accompanying notes.*

**Table of Contents****Nicholas Financial, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows****(Unaudited)**

	<b>Six months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
<b>Cash flows from operating activities</b>		
Net income	\$ 4,695,901	\$ 2,349,536
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	165,103	179,504
Gain on sale of property and equipment	(7,347)	(16,764)
Provision for credit losses	6,576,915	8,547,404
Deferred income taxes	(751,702)	(1,111,424)
Share-based compensation	229,818	339,358
Change in fair value of interest rate swaps	(532,382)	
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	29,739	(21,741)
Accounts payable and accrued expenses	(171,511)	(907,087)
Income taxes payable	(195,305)	1,277,408
Deferred revenues	(50,817)	(87,522)
<b>Net cash provided by operating activities</b>	<b>9,988,412</b>	<b>10,548,672</b>
<b>Cash flows from investing activities</b>		
Purchase and origination of finance contracts	(55,518,429)	(56,014,917)
Principal payments received	38,469,585	40,376,179
Increase in assets held for resale	(387,846)	(390,136)
Purchase of property and equipment	(57,439)	(213,536)
Proceeds from sale of property and equipment	7,347	25,755
<b>Net cash used in investing activities</b>	<b>(17,486,782)</b>	<b>(16,216,655)</b>
<b>Cash flows from financing activities</b>		
Net proceeds from line of credit	7,646,197	6,187,802
Decrease in drafts payable	(12,398)	(544,249)
Proceeds from exercise of stock options		98,056
Net excess tax benefits related to exercise of stock options		179,952
<b>Net cash provided by financing activities</b>	<b>7,633,799</b>	<b>5,921,561</b>
<b>Net increase in cash</b>	<b>135,429</b>	<b>253,578</b>
Cash, beginning of period	1,732,575	2,297,451
<b>Cash, end of period</b>	<b>\$ 1,868,004</b>	<b>\$ 2,551,029</b>

*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, 2009, 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 financial statements, although the Company believes that the disclosures made are adequate to make the information 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, 2010. 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, 2009 as filed with the Securities and Exchange Commission on June 15, 2009. The March 31, 2009 condensed consolidated balance sheet included herein has been derived from the March 31, 2009 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, the net realizable value of assets held for resale, and the fair value of interest rate swaps.

On November 10, 2009 the Board of Directors declared a 10% stock dividend on December 7, 2009 to shareholders of record on November 20, 2009. All references in the condensed consolidated financial statements and notes to the number of shares outstanding, per share amounts, and share awards of the Company s common shares have been restated to reflect the effect of the stock split for all periods presented.

**2. Revenue Recognition**

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 attributes its entire dealer discount to a reserve for credit losses. 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. After the analysis of purchase date accounting is complete, any uncollectable amounts would be contemplated in estimating the allowance for loan losses.



**Table of Contents****Nicholas Financial, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****3. Earnings Per Share (adjusted for stock dividend)**

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:

	<b>Three months ended September 30,</b>		<b>Six months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Numerator for earnings per share net income	\$ 2,432,002	\$ 791,843	\$ 4,695,901	\$ 2,349,536
Denominator:				
Denominator for basic earnings per share weighted average shares	11,400,214	11,269,314	11,400,214	11,237,891
Effect of dilutive securities:				
Stock options and other share awards	235,022	199,452	200,483	212,491
Denominator for diluted earnings per share	11,635,236	11,468,766	11,600,697	11,450,382
Earnings per share:				
Basic	\$ 0.21	\$ 0.07	\$ 0.41	\$ 0.21
Diluted	\$ 0.21	\$ 0.07	\$ 0.40	\$ 0.21

For the three months and six months ended September 30, 2009 potential common stock from stock options totaling 331,650 and 365,640, respectively, 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 consumer loans and are detailed as follows:

	<b>September 30, 2009</b>	<b>March 31, 2009</b>
Finance receivables, gross contract	\$ 316,516,852	\$ 297,925,475
Unearned interest	(90,884,564)	(85,791,963)
Finance receivables, net of unearned interest	225,632,288	212,133,512
Allowance for credit losses	(28,465,990)	(25,439,143)
Finance receivables, net	\$ 197,166,298	\$ 186,694,369

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

The terms of the receivables range from 12 to 72 months and bear a weighted average interest rate of approximately 23.5% as of September 30, 2009.

### **5. Line of Credit**

The Company has a \$115.0 million line of credit facility (the Line), which expires on November 30, 2010. The Company may borrow the lesser of the \$115.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options plus 162.5 basis points or at the prime rate. Prime rate based borrowings are generally less than \$5.0 million. The Company's cost of borrowed funds, which is based upon the interest rates charged under the Line and the effect of the interest rate swap agreements (see note 6), amounted to 4.87% and 4.90% for the three and six month periods ended September 30, 2009, respectively, as compared to 5.45% and 5.49% for the three and six month periods ended September 30, 2008, respectively. Pledged as collateral for this credit facility are all of the assets of the Company. As of September 30, 2009 the outstanding amount of the credit facility was approximately \$109.7 million and the amount available under the Line was approximately \$5.3 million. The Line requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends require consent in writing by the agent and majority lenders under the facility. As of September 30, 2009, the Company was in full compliance with all debt covenants.

**Table of Contents****Nicholas Financial, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****6. Interest Rate Swap Agreements**

Effective April 2009, the Company adopted recent provisions of the Financial Accounting Standards Board ( FASB ) Accounting Standards Codification Topic ( ASC ) 815, *Derivatives and Hedging*, enhancing disclosures to better enable financial-statement users to understand how and why the Company uses interest rate swap agreements, how the derivative instruments and related hedged items are accounted for, and how such affect the Company's financial position, financial performance and cash flows. The adoption did not have a significant impact on the consolidated financial statements.

The Company utilizes interest rate swap agreements to manage interest rate exposure. The swap agreements, in effect, convert a portion of the Company's floating rate debt to a fixed rate, more closely matching the interest rate characteristics of the Company's finance receivables.

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

	<b>Six months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>
Notional amounts at April 1	\$ 80,000,000	\$ 80,000,000
New contracts		10,000,000
Matured contracts		(10,000,000)
Notional amounts at September 30	\$ 80,000,000	\$ 80,000,000

As of September 30, 2009 and March 31, 2009, the Company had interest rate swaps comprising an aggregate notional amount of \$80,000,000 which are detailed as follows:

<b>Date Entered</b>	<b>Effective Date</b>	<b>Notional Amount</b>	<b>Fixed Rate Of Interest</b>	<b>Maturity Date</b>
March 11, 2004	October 5, 2004	\$ 10,000,000	3.64%	October 2, 2009
January 18, 2005	July 5, 2005	\$ 10,000,000	4.38%	July 2, 2010
September 9, 2005	September 13, 2005	\$ 10,000,000	4.46%	September 2, 2010
October 18, 2007	October 22, 2007	\$ 20,000,000	4.73%	November 2, 2009
November 29, 2007	December 3, 2007	\$ 10,000,000	4.04%	December 2, 2010
January 17, 2008	February 2, 2008	\$ 10,000,000	3.26%	February 2, 2011
February 6, 2008	May 19, 2008	\$ 10,000,000	2.83%	May 19, 2010

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) are recorded in earnings. Unrealized losses previously recorded in accumulated other comprehensive loss are reclassified into earnings as interest payments on the Line affect earnings over the remaining term of the respective swap agreements. The Company does not use interest rate swaps for speculative purposes. Such instruments continue to be intended for use as economic hedges.

The locations and amounts of gains (losses) recognized in income during the three and six months ended September 30, 2009 are as follows:

<b>Location</b>	<b>Three months ended September 30</b>	<b>Six months ended September 30</b>
Interest expense	\$ (762,000)	\$ (1,489,000)
Change in fair value of interest rate swaps	\$ 235,000	\$ 532,000

During the three and six months ended September 30, 2009, approximately \$293,000 and \$585,000 of unrealized losses were reclassified from accumulated other comprehensive loss to the change in fair value of interest rate swaps line item of the consolidated statement of income. At September 30, 2009 remaining accumulated other comprehensive loss, net of tax, was approximately \$395,000. Prospective amounts expected to be reclassified and affect net earnings are \$217,000 during the remainder of fiscal 2010 and \$178,000 during fiscal 2011.

**Table of Contents****Nicholas Financial, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****6. Interest Rate Swap Agreements (continued)**

In addition, the changes in the fair value of interest rate swaps for the three and six months ended September 30, 2009 of approximately \$528,000 and \$1,117,000, respectively, were recorded in the change in fair value of interest rate swaps line item of the consolidated statement of income.

The Company records net realized gains and losses from the swap agreements into the interest expense line item of the consolidated statement of income. Such settlement payments approximated \$762,000 and \$315,000 for the three months ended September 30, 2009 and 2008, respectively. Such settlement payments approximated \$1,489,000 and \$604,000 for the six months ended September 30, 2009 and 2008, respectively.

Under the swap agreements, the Company received an average variable rate of 0.28% and 2.47% and paid an average fixed rate of 4.01% and 4.01% for the three months ended September 30, 2009 and 2008, respectively. Under the swap agreements, the Company received an average variable rate of 0.35% and 2.56% and paid an average fixed rate of 4.01% and 4.05% for the six months ended September 30, 2009 and 2008, respectively. The interest rate swap liabilities are recorded at fair value, which is approximately \$1,637,000 and \$2,755,000 as of September 30, 2009 and March 31, 2009, respectively, in the interest rate swaps line item of the consolidated balance sheets. Accumulated other comprehensive loss as of September 30, 2009 and March 31, 2009 of approximately \$395,000 and \$756,000, respectively, represents the after-tax effect changes in the fair value of interest rate swaps prior to October 2008 when the swaps were designated and qualifying as cash flow hedges. As noted above, these changes in fair value were previously recorded in accumulated other comprehensive loss while interest rate swaps were designated as cash flow hedges are reclassified into earnings as interest payments on the Line affect earnings over the remaining term of the respective swap agreements.

The following table reconciles net income with comprehensive income.

	<b>Three months ended September 30,</b>		<b>Six months ended September 30,</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net income	\$ 2,432,002	\$ 791,843	\$ 4,695,901	\$ 2,349,536
Change in fair value of interest rate swaps, net of tax expense of \$11,294 and \$677,895, respectively.		18,210		1,092,991
Reclassification adjustment for loss included in net income, net of tax benefit of \$111,963 and \$223,926, respectively.	180,520		361,040	
Comprehensive income	\$ 2,612,522	\$ 810,053	\$ 5,056,941	\$ 3,442,527

**7. Fair Value Disclosures**

ASC 820, *Fair Value Measurements and Disclosures*, establishes a framework for using fair value and defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also establishes a fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs may be used to measure fair value:

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Level 1 - Quoted prices in active markets for identical assets or liabilities such as debt and equity securities and derivative contracts that are traded in an active market.

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include derivative contracts whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

**Table of Contents****Nicholas Financial, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements (Continued)****(Unaudited)****7. Fair Value Disclosures (continued)**

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Effective April 1, 2009, the Company adopted recent provisions of ASC 825, *Financial Instruments*, broadening the disclosures about the fair value of financial instruments to interim financial reporting. The adoption of did not have a significant impact on the consolidated financial statements. The Company's financial instruments consist of cash, finance receivables, accrued interest, accounts receivable, the Line, interest rate swap agreements and accounts payable. For each of these financial instruments, excluding the Line, the carrying value is, or approximates, fair value. The carrying value of cash and cash equivalents 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. 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. Accrued interest is paid monthly. As a result of the short term nature of accrued interest and accounts payable, the carrying values approximate fair value. The interest rate for the Line is a variable rate based on LIBOR pricing options or at the prime rate. Any new or renewed credit facility would contain pricing that is materially higher than the Company's current Line. Based on market conditions, the fair value of the Line was estimated to be \$107,500,000 and \$98,800,000 as of September 30, 2009 and March 31, 2009, respectively.

Interest rate swap agreements are recorded at fair value on a recurring basis. The Company estimates the fair value based on the estimated net present value of the future cash flows using a forward interest rate yield curve in effect as of the measurement period, adjusted for nonperformance risk, if any, including a quantitative and/or qualitative evaluation of both the Company's credit risk and the counterparty's credit risk. Accordingly, the Company classifies interest rate swap agreements as Level 2. Due to the uncertainty inherent in the valuation process, such estimates of fair value may differ significantly from the values that would have been used had a ready market for the securities existed.

**Assets and Liabilities Recorded at Fair Value on a Recurring Basis**

The following table presents information about certain assets and liabilities measured at fair value:

Description	Fair Value Measurement Using			Assets/Liabilities Measured at Fair Value
	Level 1	Level 2	Level 3	
Interest rate swap agreements:				
September 30, 2009	\$	\$ 1,637,412	\$	\$ 1,637,412
March 31, 2009	\$	\$ 2,754,760	\$	\$ 2,754,760

**Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis**

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.

**8. Other Recently Issued Accounting Standards**

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Effective April 1, 2009, the Company adopted recent provisions of ASC 820 with respect to non-financial assets and liabilities as well recent provisions providing additional guidance on estimating fair value when the volume and level of transaction activity for an asset or liability have significantly decreased in relation to the usual activity for said asset or liability. The recent provisions also provide guidance on how to identify circumstances that could designate a transaction as not orderly. The adoption did not have a significant impact on the consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its EITF), the AICPA, and the SEC did not, and are not believed by the Company to have a material impact on the Company's present or future consolidated financial statements.



**Table of Contents**

**Nicholas Financial, Inc. and Subsidiaries**

**Notes to the Condensed Consolidated Financial Statements (Continued)**

**(Unaudited)**

**9. Subsequent Events**

The Company has evaluated subsequent events through November 13, 2009 which is the date that the condensed consolidated financial statements were issued. On November 10, 2009 the Board of Directors declared a 10% stock dividend on December 7, 2009 to shareholders of record on November 20, 2009.

---

**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 Form 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 loss based on management's evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans and current economic conditions. Such evaluation, which includes a review of all loans on which full collectability may not be reasonably assured, 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 at which 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 performs internal branch audits 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 and the wholesale value of the vehicle. The automotive dealer accepts these terms by executing a dealer agreement with the Company. 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 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 quarterly to determine if the loss reserves are adequate and adjustments are made if they are determined to be necessary.

## **Introduction**

Consolidated net income increased to approximately \$2.4 million for the three-month period ended September 30, 2009 as compared to \$792,000 for the corresponding period ended September 30, 2008. Net income for the three months ended September 30, 2009 includes a pre-tax gain of approximately \$235,000 related to the change in fair value of interest rate swaps. Consolidated net income increased to approximately \$4.7 million for the six-month period ended September 30, 2009 as compared to \$2.3 million for the corresponding period ended September 30, 2008. Net income for the six months ended September 30, 2009 includes a pre-tax gain of approximately \$532,000 related to the change in fair value of interest rate swaps. Earnings were favorably impacted primarily by an increase in the average net receivables, a decrease in operating expenses as a percentage of average finance receivables, net of unearned interest, a reduction in the provision for credit losses and a decrease in the average cost of borrowed funds. The Company's software subsidiary, Nicholas Data Services ( NDS ), did not contribute significantly to consolidated operations in the three and six months ended September 30, 2009 or 2008, respectively.

As discussed in note 6 Interest Rate Swaps , the Company made an economic decision which resulted in undesignating the interest rate swaps as cash flow hedges. Under accounting rules this has introduced volatility to the statement of income for changes in the fair value of interest rate swaps that historically have been captured in accumulated comprehensive income or loss in the statement of shareholders' equity. The Company intends to hold interest rate swaps through their entire term. Accordingly, over the term of each interest rate swap agreement, the unrealized gains and losses from changes in the fair value of interest rate swaps, which are now recorded in the change in fair value of interest rate swaps line item of the statement of income, will net or offset to \$0 and cumulatively have no impact on retained earnings.

For the three months ended September 30, 2009, net earnings, excluding changes in fair value of interest rate swaps, increased 190% to \$2.3 million compared to \$792,000 for the three months ended September 30, 2008. Per share diluted net earnings, excluding changes in fair value of interest rate swaps, increased 175% to \$0.20 for the three months ended September 30, 2009 as compared to \$0.07 for the three months ended September 30, 2008.

For the six months ended September 30, 2009, net earnings, excluding changes in fair value of interest rate swaps, increased 83% to \$4.4 million compared to \$2.4 million for the six months ended September 30, 2008. Per share diluted net earnings, excluding changes in fair value of interest rate swaps, increased 78% to \$0.38 for the six months ended September 30, 2009 as compared to \$0.21 for the six months ended September 30, 2008.

**See reconciliations of the non-GAAP measures on the following page.**

**Table of Contents****Reconciliation of Non-GAAP Financial Measures**

This filing contains disclosures of non-GAAP financial measures including: net earnings, excluding changes in fair value of interest rate swaps and per share diluted net earnings, excluding changes in fair value of interest rate swaps. These measures utilize the GAAP terms net income and diluted earnings per share and adjust the GAAP terms to exclude the effect of mark to market adjustments and reclassifications of previously recorded accumulated comprehensive gains and losses associated with interest rate swaps. Management believes this presentation provides additional and meaningful measures for the assessment of the Company's ongoing results and performance. Because the Company has historically reported mark-to-market (interest rate swaps) through other comprehensive income under hedge accounting, management believes that the inclusion of this non-GAAP measure provides consistency in its financial reporting and facilitates investors' understanding of the Company's historic operating trends by providing an additional basis for comparisons to prior periods. Management recognizes that the use of non-GAAP measures has limitations, including the fact that they may not be directly comparable with similar non-GAAP financial measures used by other companies. All non-GAAP financial measures are intended to supplement the applicable GAAP disclosures and should not be considered in isolation from, or as substitute for, financial information prepared in accordance with GAAP. For a reconciliation of non-GAAP measures from GAAP reported amounts, please see the supplemental information below.

The following tables include reconciliations of GAAP reported net income to the non-GAAP measure, net earnings, excluding changes in fair value of interest rate swaps as well as GAAP reported diluted earnings per share to the non-GAAP measure, per share diluted net earnings, excluding changes in fair value of interest rate swaps. The non-GAAP measures exclude the effect of mark-to-market adjustments and reclassifications of previously recorded accumulated comprehensive losses associated with interest rate swaps.

	Three months ended		Six months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Net income, GAAP	\$ 2,432,002	\$ 791,843	\$ 4,695,902	\$ 2,349,536
Mark-to-market gain on interest rate swaps, net of tax expense of \$89,379 and \$203,631	(145,699)		(328,751)	
Net earnings, excluding changes in fair value of interest rate swaps (a)	\$ 2,286,303	\$ 791,843	\$ 4,367,151	\$ 2,349,536

	Three months ended		Six months ended	
	September 30,		September 30,	
	2009	2008	2009	2008
Diluted earnings per share, GAAP	\$ 0.21	\$ 0.07	\$ 0.40	\$ 0.21
Per diluted share mark-to-market gain on interest rate swaps	(0.01)		(0.02)	
Per share diluted net earnings, excluding changes in fair value of interest rate swaps (a)	\$ 0.20	\$ 0.07	\$ 0.38	\$ 0.21

(adjusted for stock dividend)

(a) Represents a non-GAAP financial measure. See information on non-GAAP financial measures above.

**Table of Contents**

Portfolio Summary	Three months ended September 30,		Six months ended September 30,	
	2009	2008	2009	2008
Average finance receivables, net of unearned interest (1)	\$ 222,701,667	\$ 208,674,423	\$ 219,211,625	\$ 206,001,623
Average indebtedness (2)	\$ 106,342,703	\$ 105,150,419	\$ 104,667,063	\$ 103,503,324
Finance revenue (3)	\$ 14,138,708	\$ 13,487,161	\$ 27,811,980	\$ 26,591,127
Interest expense	1,293,561	1,431,677	2,566,238	2,841,013
Net finance revenue	\$ 12,845,147	\$ 12,055,484	\$ 25,245,742	\$ 23,750,114
Weighted average contractual rate (4)	23.49%	24.15%	23.70%	24.16%
Average cost of borrowed funds (2)	4.87%	5.45%	4.90%	5.49%
Gross portfolio yield (5)	25.39%	25.85%	25.37%	25.82%
Interest expense as a percentage of average finance receivables, net of unearned interest	2.32%	2.74%	2.34%	2.76%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	5.84%	9.86%	6.00%	8.30%
Net portfolio yield (5)	17.23%	13.25%	17.03%	14.76%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	10.53%	10.75%	10.51%	10.89%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	6.70%	2.50%	6.52%	3.87%
Write-off to liquidation (8)	11.11%	12.97%	10.96%	12.09%
Net charge-off percentage (9)	8.24%	10.25%	7.98%	9.82%

**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) Finance revenue does not include revenue generated by Nicholas Data Services, Inc., ( NDS ) the wholly-owned software subsidiary of Nicholas Financial, Inc.
- (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)

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

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 \$9,000 during the three-month periods ended September 30, 2009 and 2008 and \$109,000 and \$211,000 during the six-month periods ended September 30, 2009 and 2008, 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, 2009 compared to three months ended September 30, 2008**

**Interest Income and Loan Portfolio**

Interest income on finance receivables, predominately finance charge income, increased 4% to approximately \$14.1 million for the three-month period ended September 30, 2009 from \$13.5 million for the corresponding period ended September 30, 2008. Average finance receivables, net of unearned interest equaled approximately \$222.7 million for the three-month period ended September 30, 2009, an increase of 7% from \$208.7 million for the corresponding period ended September 30, 2008. 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 the opening of two additional branch locations. The gross finance receivable balance increased 7% to approximately \$316.5 million as of September 30, 2009, from \$295.7 million as of September 30, 2008. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 25.85% for the three-month period ended September 30, 2008 to 25.39% for the three-month period ended September 30, 2009. The net portfolio yield increased from 13.25% for the three-month period ended September 30, 2008 to 17.23% for the corresponding period ended September 30, 2009. The gross portfolio yield decreased primarily due to a lower weighted annual percentage rate ( APR ) earned on finance receivables. The net portfolio yield increased due to a decrease in the average cost of borrowed funds and a reduction 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 \$5.9 million for the three-month period ended September 30, 2009 from approximately \$5.6 million for the corresponding period ended September 30, 2008. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.53% for the three-month period ended September 30, 2009 from 10.75% for the three-month period ended September 30, 2008.

**Interest Expense**

Interest expense decreased to approximately \$1.3 million for the three-month period ended September 30, 2009 from \$1.4 million for the three-month period ended September 30, 2008. The average indebtedness for the three-month period ended September 30, 2009 increased to approximately \$106.3 million as compared to \$105.2 million for the corresponding period ended September 30, 2008. The Company's average cost of borrowed funds decreased to 4.87% for the three-month period ended September 30, 2009 as compared to 5.45% for the corresponding period ended September 30, 2008. The primary reasons the Company's average cost of funds decreased is the weighted-average 30-day LIBOR rate decreased from 2.47% for the three months ended September 30, 2008 as compared to 0.28% for the three months ended September 30, 2009. The reduction in 30-day LIBOR rates was offset in part by the Company's interest rate swap agreements, which convert a majority of the Company's floating rate debt to fixed rate debt. For further discussions regarding the Company's cost of funds and the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements .

---

**Table of Contents**

**Six months ended September 30, 2009 compared to six months ended September 30, 2008**

**Interest Income and Loan Portfolio**

Interest income on finance receivables, predominately finance charge income, increased 5% to approximately \$27.8 million for the six-month period ended September 30, 2009 from \$26.6 million for the corresponding period ended September 30, 2008. Average finance receivables, net of unearned interest equaled approximately \$219.2 million for the six-month period ended September 30, 2009, an increase of 6% from \$206.0 million for the corresponding period ended September 30, 2008. 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 the opening of two additional branch locations. The gross finance receivable balance increased 7% to approximately \$316.5 million as of September 30, 2009, from \$295.7 million as of September 30, 2008. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 25.82% for the six-month period ended September 30, 2008 to 25.37% for the six-month period ended September 30, 2009. The net portfolio yield increased from 14.76% for the six-month period ended September 30, 2008 to 17.03% for the corresponding period ended September 30, 2009. The gross portfolio yield decreased primarily due to a lower weighted annual percentage rate ( APR ) earned on finance receivables. The net portfolio yield increased due to a decrease in the average cost of borrowed funds and a reduction 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 \$11.6 million for the six-month period ended September 30, 2009 from approximately \$11.4 million for the corresponding period ended September 30, 2008. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.51% for the six-month period ended September 30, 2009 from 10.89% for the six-month period ended September 30, 2008.

**Interest Expense**

Interest expense decreased to approximately \$2.6 million for the six-month period ended September 30, 2009 from \$2.8 million for the six-month period ended September 30, 2008. The average indebtedness for the six-month period ended September 30, 2009 increased to approximately \$104.7 million as compared to \$103.5 million for the corresponding period ended September 30, 2008. The Company's average cost of borrowed funds decreased to 4.90% for the six-month period ended September 30, 2009 as compared to 5.49% for the corresponding period ended September 30, 2008. The primary reasons the Company's average cost of funds decreased is the weighted-average 30-day LIBOR rate decreased from 2.6% for the six months ended September 30, 2008 as compared to 0.35% for the six months ended September 30, 2009. The reduction in 30-day LIBOR rates was offset in part by the Company's interest rate swap agreements, which convert a majority of the Company's floating rate debt to fixed rate debt. For further discussions regarding the Company's cost of funds and 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 twelve 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, 2009 and 2008, less than 3% were for new vehicles. As of September 30, 2009, the average model year of vehicles collateralizing the portfolio was a 2004 vehicle.

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,	
	2009	2008	2009	2008
FL	\$ 12,088,200	\$ 10,067,166	\$ 23,638,790	\$ 23,667,921
GA	3,071,557	2,505,658	6,086,909	5,922,477
NC	3,311,508	2,990,283	6,396,429	6,331,883
SC	681,947	618,337	1,303,100	1,289,162
OH	4,659,872	3,987,642	9,091,707	8,372,575
MI	933,960	816,741	1,889,779	1,354,399
VA	816,660	1,272,657	1,753,763	2,803,933
IN	1,578,215	1,896,940	3,327,696	3,565,340
KY	2,074,737	1,448,986	4,158,346	3,226,898
MD	261,735	715,885	572,619	1,353,666
AL	1,110,039	767,292	1,962,665	1,890,225
TN	674,550	575,231	1,170,444	1,208,790
<b>Total</b>	<b>\$ 31,262,980</b>	<b>\$ 27,662,818</b>	<b>\$ 61,352,247</b>	<b>\$ 60,987,269</b>

Contracts	Three months ended September 30,		Six months ended September 30,	
	2009	2008	2009	2008
Purchases	\$ 31,262,980	\$ 27,662,818	\$ 61,352,247	\$ 60,987,269
Weighted APR	23.38%	24.15%	23.59%	24.16%
Average discount	8.96%	8.94%	9.07%	8.82%
Weighted average term (months)	49	48	49	48
Average loan	\$ 9,468	\$ 9,400	\$ 9,456	\$ 9,483
Number of Contracts	3,302	2,943	6,488	6,431

**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,	
	2009	2008	2009	2008

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Originations	\$ 1,061,348	\$ 1,146,702	\$ 2,011,070	\$ 2,374,951
Weighted APR	26.76%	27.36%	26.89%	27.08%
Weighted average term (months)	24	23	23	25
Average loan	\$ 2,660	\$ 2,461	\$ 2,629	\$ 2,613
Number of loans	399	466	765	909

**Table of Contents****Analysis of Credit Losses**

As of September 30, 2009, the Company had 1,000 active static pools. The average pool upon inception consisted of 62 Contracts with aggregate finance receivables, net of unearned interest, of approximately \$580,000.

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,	
	2009	2008	2009	2008
Balance at beginning of period	\$ 26,580,254	\$ 21,200,672	\$ 24,926,076	\$ 20,112,260
Discounts acquired on new volume	2,796,052	2,484,783	5,559,465	5,378,928
Current period provision	3,296,669	4,953,258	6,541,738	8,094,549
Losses absorbed	(5,016,563)	(5,694,539)	(9,625,047)	(10,788,417)
Recoveries	462,682	449,779	909,657	873,936
Discounts accreted	(58,104)	(209,976)	(250,899)	(487,279)
<b>Balance at end of period</b>	<b>\$ 28,060,990</b>	<b>\$ 23,183,977</b>	<b>\$ 28,060,990</b>	<b>\$ 23,183,977</b>

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,	
	2009	2008	2009	2008
Balance at beginning of period	\$ 538,085	\$ 446,495	\$ 513,067	\$ 335,057
Current period provision	(42,710)	191,692	35,177	452,855
Losses absorbed	(104,004)	(162,918)	(170,528)	(332,974)
Recoveries	13,629	7,905	27,284	28,236
<b>Balance at end of period</b>	<b>\$ 405,000</b>	<b>\$ 483,174</b>	<b>\$ 405,000</b>	<b>\$ 483,174</b>

The Company has seen evidence that the changes made to underwriting guidelines approximately one year ago have resulted in a positive effect on the static pools originated during that same timeframe. During comparable liquidation cycles, the default rate for static pools originated during the last year has decreased when compared to the preceding year's performance. However, from a historical perspective, charge-off rates remain high and the Company believes that continued weakness in employment will make it difficult for additional improvement. As a result, the Company experienced a lower net charge-off percentage of 8.24% during the three-month period ended September 30, 2009 as compared to 10.25% for the three-month period ended September 30, 2008. The Company experienced a lower net charge-off percentage of 7.98% during the six-month period ended September 30, 2009 as compared to 9.82% for the six-month period ended September 30, 2008. While the Company is encouraged with the decline in net charge-offs for these periods, delinquencies, as set forth in the tables below, have increased, leading to an increase in the overall allowance for credit losses as a percentage of finance receivables.

The average dealer discount associated with new volume for the three months ended September 30, 2009 and 2008 were 8.96% and 8.94%, respectively. The average dealer discount associated with new volume for the six months ended September 30, 2009 and 2008 were 9.07% and 8.82%, respectively. The amount of discount is a result of credit quality associated with contracts purchased and the competition in the markets in which the Company operates. The Company intends to remain focused on maintaining these discount levels to help off-set the rising loss rates it has been experiencing.

With the decrease in the net charge off percentage noted above, the provision for credit losses decreased from approximately \$5.1 million for the three-month period ended September 30, 2008, to \$3.3 million for the three-month period ended September 30, 2009. The provision for credit losses decreased from approximately \$8.5 million for the six-month period ended September 30, 2008, to \$6.6 million for the six-month period ended September 30, 2009. The Company's losses absorbed as a percentage of liquidation decreased from 12.97% for the three months ended

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

September 30, 2008, to 11.11% for the three months ended September 30, 2009. The Company's losses absorbed as a percentage of liquidation decreased from 12.09% for the six months ended September 30, 2008, to 10.96% for the six months ended September 30, 2009. In addition, excess provisions reversed, increased from \$0 for the three-month period ended September 30, 2008 to approximately \$103,000 for the three-month period ended September 30, 2009. Provisions reversed increased from \$10,000 for the six-month period ended September 30, 2008 to approximately \$253,000 for the six-month period ended September 30, 2009. The reversal of provisions previously recorded in each period was due to the favorable charge-off performance of static pools originated from April 2005 through March 2006.

**Table of Contents**

The Company anticipates losses absorbed as a percentage of liquidation will be in the 11%-14% 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. Effective October 1, 2008, the Company modified its Contract procurement underwriting guidelines. The primary changes include: raising the minimum income required by the debtor to qualify for loan approval, reducing the maximum dollar amount that can be advanced for certain loan applications, and the maximum dollar amount that can be approved by a branch manager on certain approvals. The longer-term outlook for portfolio performance will depend on the overall economic conditions, the unemployment rate, the economic impact of any government sponsored stimulus package, 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, terms or quality of Contracts purchased during the three and six months ended September 30, 2009 that would have contributed to the decrease in losses.

Recoveries as a percentage of charge-offs increased from approximately 9% for the three months ended September 30, 2008 to approximately 10% for the three months ended September 30, 2009. Recoveries as a percentage of charge-offs increased from approximately 9% for the six months ended September 30, 2008 to approximately 11% for the six months ended September 30, 2009. Historically, recoveries as a percentage of charge-off's fluctuate from period to period and the Company does not attribute this increase to any particular change in operational strategy or economic event.

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:

Contracts	Gross Balance Outstanding	Delinquencies				Total
		30 59 days	60 89 days	90 + days		
<b>September 30, 2009</b>	<b>\$ 310,564,055</b>	<b>\$ 10,944,006</b>	<b>\$ 4,366,307</b>	<b>\$ 1,537,826</b>	<b>\$ 16,848,139</b>	
		3.52%	1.41%	0.50%	5.43%	
September 30, 2008	\$ 287,272,780	\$ 9,621,940	\$ 3,763,896	\$ 1,407,925	\$ 14,793,761	
		3.35%	1.31%	0.49%	5.15%	
Direct Loans	Gross Balance Outstanding	Delinquencies				Total
		30 59 days	60 89 days	90 + days		
<b>September 30, 2009</b>	<b>\$ 5,952,797</b>	<b>\$ 169,242</b>	<b>\$ 57,787</b>	<b>\$ 50,457</b>	<b>\$ 277,486</b>	
		2.84%	0.97%	0.85%	4.66%	
September 30, 2008	\$ 8,472,099	\$ 145,174	\$ 64,682	\$ 67,351	\$ 277,207	
		1.71%	0.76%	0.80%	3.27%	

The delinquency percentage for Contracts more than thirty days past due as of September 30, 2009 was 5.43% as compared to 5.15% as of September 30, 2008. The delinquency percentage for direct loans more than thirty days past due as of September 30, 2009 was 4.66% as compared to 3.27% as of September 30, 2008.

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 internal branch audits as an indication 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.

**Table of Contents****Income Taxes**

The provision for income taxes increased to approximately \$1.5 million for the three months ended September 30, 2009 as compared to approximately \$545,000 for the three months ended September 30, 2008. The provision for income taxes increased to approximately \$2.9 million for the six months ended September 30, 2009 as compared to approximately \$1.4 million for the six months ended September 30, 2008. The Company's effective tax rate decreased from 40.78% for the three months ended September 30, 2008 to 38.02% for the three months ended September 30, 2009. The Company's effective tax rate increased from 38.09% for the six months ended September 30, 2008 to 38.25% for the six months ended September 30, 2009. The primary reason for this increase was the result of a portion of the Company's taxable income reaching the 35% maximum Federal tax rate.

**Liquidity and Capital Resources**

The Company's cash flows are summarized as follows:

	Six months ended September 30,	
	2009	2008
Cash provided by (used in):		
Operating activities	\$ 9,988,412	\$ 10,548,672
Investing activities (primarily purchase of Contracts)	(17,486,782)	(16,216,655)
Financing activities	7,633,799	5,921,561
Net increase in cash	\$ 135,429	\$ 253,578

The Company's primary use of working capital for the six months ended September 30, 2009 was the funding of the purchase of Contracts. The Company's Line is secured by all of the assets of the Company's Nicholas Financial, Inc. subsidiary. As of September 30, 2009 the Company could borrow the lesser of \$115.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options plus 162.5 basis points or at the prime rate. Prime rate based borrowings are generally less than \$5.0 million. As of September 30, 2009, the amount outstanding under the Line was approximately \$109.7 million and the amount available under the Line was approximately \$5.3 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 increased by \$7.6 million during the six months ended September 30, 2009. The growth of the Line is principally related to funding the purchase of Contracts and is consistent with the growth of finance receivables.

The Company is currently negotiating an amendment to the Line, which will increase the size of the Line and extend the maturity date U.S. and global market economic conditions continue to remain weak, particularly in the financial sector, where credit markets are not operating at the same level of liquidity compared to historical market conditions. As a result, the Company will experience increased pricing once the amendment is executed. The Company anticipates executing the aforementioned amendment during the third quarter, which ends December 31, 2009.

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, 2010. 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.

The Company has entered into interest rate swap agreements, each of which, in effect, convert a portion of the Company's floating-rate debt to a fixed-rate, thus reducing the impact of interest rate change on the Company's interest expense. As of September 30, 2009, approximately 73% of the Company's borrowings under the Line were subject to interest rate swap agreements. These swap agreements have maturities ranging from October 2, 2009 through February 2, 2011.



## **Table of Contents**

### **Future Expansion**

The Company currently operates a total of forty-nine branch locations in twelve states, including nineteen in Florida, seven in Ohio, five in North Carolina, five in Georgia, three in Kentucky, two in Virginia, two in Indiana, two in Alabama and one in Michigan, Maryland, South Carolina, and Tennessee. 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 outstanding finance receivables, net of unearned interest. To date, ten of our branches have reached this capacity. While the Company remains cautious, we are encouraged that the economy is showing some signs of stability and subject to favorable market conditions we will proceed with our planned expansion. This expansion will include a new branch location in Gastonia, North Carolina, which will bring our number of branch locations to 50 in 12 states. Additional markets are currently being evaluated for future branch locations.

### **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. During fiscal 2009, the Company undesignated all of its interest rate swaps as cash flow hedges. (See note 6

Interest Rate Swaps ) The Company does not use interest rate swaps for speculative purposes. Such instruments continue to be intended for use as economic hedges.

### **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, 2009, 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 13, 2009

/s/ PETER L. VOSOTAS  
**Peter L. Vosotas**  
**Chairman of the Board, President,**  
**Chief Executive Officer and Director**

Date: November 13, 2009

/s/ RALPH T. FINKENBRINK  
**Ralph T. Finkenbrink**  
**Senior Vice President,**  
**Chief Financial Officer and Director**

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
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