

NICHOLAS FINANCIAL INC  
Form 10-Q  
August 09, 2013  
[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 June 30, 2013**

.. **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 the filing requirements for at least 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 August 1, 2013, the registrant had 12,180,239 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>Consolidated Balance Sheets as of June 30, 2013 and March 31, 2013</u>	2
<u>Consolidated Statements of Income for the three months ended June 30, 2013 and 2012</u>	3
<u>Consolidated Statements of Cash Flows for the three months ended June 30, 2013 and 2012</u>	4
<u>Notes to the Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	13
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	20
Item 4. <u>Controls and Procedures</u>	20
<b><u>Part II. Other Information</u></b>	
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

Consolidated Balance Sheets

	June 30, 2013 (Unaudited)	March 31, 2013
<b>Assets</b>		
Cash	\$ 3,658,951	\$ 2,797,716
Finance receivables, net	255,257,992	249,825,801
Assets held for resale	1,782,023	1,203,664
Income taxes receivable		102,999
Prepaid expenses and other assets	739,704	736,746
Property and equipment, net	756,581	741,581
Interest rate swap agreements	328,407	
Deferred income taxes	7,568,768	8,426,961
Total assets	\$ 270,092,426	\$ 263,835,468
<b>Liabilities and shareholders equity</b>		
Line of credit	\$ 126,021,510	\$ 125,500,000
Drafts payable	1,823,520	2,096,311
Accounts payable and accrued expenses	6,665,061	7,405,579
Income taxes payable	2,500,070	
Interest rate swap agreements		504,852
Deferred revenues	1,604,553	1,363,630
Total liabilities	138,614,714	136,870,372
<b>Shareholders equity</b>		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 12,176,029 and 12,154,069 shares issued and outstanding, respectively	30,304,043	30,031,548
Retained earnings	101,173,669	96,933,548
Total shareholders equity	131,477,712	126,965,096
Total liabilities and shareholders equity	\$ 270,092,426	\$ 263,835,468

*See accompanying notes.*

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Consolidated Statements of Income

(Unaudited)

	<b>Three months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>Revenue:</b>		
Interest and fee income on finance receivables	\$ 20,469,372	\$ 20,417,957
Sales	6,363	9,769
	20,475,735	20,427,726
<b>Expenses:</b>		
Cost of sales	2,295	3,363
Marketing	396,074	374,332
Salaries and employee benefits	4,851,450	4,524,486
Administrative	2,598,651	2,098,938
Provision for credit losses	2,641,791	3,103,266
Dividend tax	73,019	60,416
Depreciation	75,335	72,467
Interest expense	1,404,906	1,192,140
Change in fair value of interest rate swap agreements	(833,259)	209,101
	11,210,262	11,638,509
Operating income before income taxes	9,265,473	8,789,217
Income tax expense	3,564,980	3,381,761
Net income	\$ 5,700,493	\$ 5,407,456
<b>Earnings per share:</b>		
Basic	\$ 0.47	\$ 0.45
Diluted	\$ 0.46	\$ 0.44
Dividends declared per share	\$ 0.12	\$ 0.10

*See accompanying notes.*

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended	
	June 30,	
	2013	2012
<b>Cash flows from operating activities</b>		
Net income	\$ 5,700,493	\$ 5,407,456
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	75,335	72,467
Gain on sale of property and equipment	(2,013)	
Provision for credit losses	2,641,791	3,103,266
Amortization of dealer discounts	(2,974,446)	(3,147,869)
Deferred income taxes	858,193	(253,697)
Share-based compensation	122,259	281,707
Change in fair value of interest rate swap agreements	(833,259)	209,101
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(2,958)	(2,957)
Accounts payable and accrued expenses	(740,518)	(348,076)
Income taxes payable	2,603,069	3,598,939
Deferred revenues	240,923	18,692
Net cash provided by operating activities	7,688,869	8,939,029
<b>Cash flows from investing activities</b>		
Purchase and origination of finance receivables	(39,328,663)	(34,792,569)
Principal payments received	34,229,127	32,533,699
Increase in assets held for resale	(578,359)	(109,500)
Purchase of property and equipment	(101,122)	(86,466)
Proceeds from sale of property and equipment	12,800	
Net cash used in investing activities	(5,766,217)	(2,454,836)
<b>Cash flows from financing activities</b>		
Net proceeds from (repayment of) line of credit	521,510	(3,000,000)
Decrease in drafts payable	(272,791)	(112,270)
Payment of cash dividends	(1,460,372)	(1,208,328)
Proceeds from exercise of stock options	83,140	51,210
Excess tax benefits from exercise of stock options	67,096	31,525
Net cash used in financing activities	(1,061,417)	(4,237,863)
Net increase in cash	861,235	2,246,330
Cash, beginning of period	2,797,716	2,803,054
Cash, end of period	\$ 3,658,951	\$ 5,049,384

*See accompanying notes.*



---

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

**1. Basis of Presentation**

The accompanying consolidated balance sheet as of March 31, 2013, which has been derived from audited financial statements, and the accompanying unaudited interim 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 (U.S. 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 U.S. 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, 2014. It is suggested that these 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, 2013 as filed with the Securities and Exchange Commission on June 14, 2013. The March 31, 2013 consolidated balance sheet included herein has been derived from the March 31, 2013 audited consolidated balance sheet included in the aforementioned Form 10-K.

The preparation of consolidated financial statements in conformity with U.S. 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 fair value of interest rate swap agreements.

As previously disclosed in the Company's Annual Report on Form 10-K for the year ended March 31, 2013, the Company made error corrections for departures from U.S. GAAP and revised previously reported amounts. One of the corrections is related to the accounting treatment for dealer discounts. A dealer discount represents the difference between the amount of a finance receivable, net of unearned interest, based on the terms of a Contract with the borrower, and the amount of money the Company actually pays the dealer for the Contract. Prior to the correction, based on past industry practices, Contracts were recorded at the net initial investment with the gross Contract balance recorded offset by the dealer discounts which were recorded as an allowance for credit losses for the acquired Contracts. The Company determined that this accounting treatment was incorrect as U.S. GAAP prohibits carrying over valuation allowances in the initial accounting for acquired loans. Accordingly, the Company has now applied an acceptable method under U.S. GAAP, deferring and netting dealer discounts against finance receivables as unearned discounts, and recognizing dealer discounts into income as an adjustment to yield over the life of the loan using the interest method.

As a result, the allowance for loan losses is now established solely through charges to earnings through the provision for credit losses. The Company has evaluated the significance of the departure from U.S. GAAP to the consolidated financial statements. Under both the former accounting policy and U.S. GAAP, the dealer discount remains a reduction of gross finance receivables in arriving at the carrying amount of finance receivables, net. Accordingly, finance receivables continue to be initially recorded at the net initial investment at the time of purchase. Subsequently, the allowance for credit losses is maintained at an amount that reduces the net carrying amount of finance receivables. The change in this accounting presentation does not result in a change to the net carrying amount of finance receivables or to net income as historical losses incurred, and estimated incurred losses as of the balance sheet date, are generally in excess of the original dealer discount. The removal of the dealer discount from the allowance requires an equal replacement of provision expense as that portion of the allowance is necessary to absorb probable incurred losses. This correction also did not have an impact on previously reported assets, liabilities, working capital, equity, earnings, or cash flows.

The second correction related to the accounting treatment and presentation of certain fees charged to dealers and costs incurred in purchasing loans from dealers. Such costs related principally to evaluating borrowers subject to Contracts in relation to the Company's underwriting guidelines in making a determination to acquire Contracts. Prior to the correction, fees charged to dealers were reduced by certain costs incurred to purchase Contracts, deferred on a net basis and then amortized into income over the lives of the loans using the interest method. Under U.S. GAAP, the fees charged to dealers are considered to be a part of the unearned dealer discount as they are a determinant of the net amount of cash paid to the dealer. Further, U.S. GAAP specifies that costs incurred in connection with acquiring purchased loans or committing to purchase loans shall be charged to expense as incurred. Such costs do not qualify as origination costs to be deferred as the Contracts have already been originated by the dealers.





**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**1. Basis of Presentation (continued)**

The Company evaluated the significance of the departures from U.S. GAAP to the consolidated financial statements. After an adjustment to beginning equity and the opening balance of unearned dealer discounts, net of tax, for the initial period presented, there is a limited effect on earnings and no impact on cash flows.

The changes to consolidated financial statement captions and earnings per share, if any, are as follows.

	June 30, 2012 as Reported	Correction	June 30, 2012 as Corrected
<b>Consolidated Balance Sheet</b>			
Finance receivables, net	\$ 244,597,019	\$ (1,040,115)	\$ 243,556,904
Deferred income taxes	8,978,840	399,157	9,376,997
Retained earnings, June 30, 2012	111,678,205	(641,958)	111,036,247
<b>Consolidated Statements of Income</b>			
Interest and fee income on finance receivables	\$ 17,270,088	\$ 3,147,869	\$ 20,417,957
Provision for credit losses	10,372	3,092,894	3,103,266
Operating income	8,734,242	54,975	8,789,217
Income tax expense	3,360,717	21,044	3,381,759
Net income	5,373,525	33,931	5,407,456
Earnings per share basic	0.45		0.45
Earnings per share diluted	0.44		0.44
<b>Consolidated Statements of Cash Flows (Operating Activities)</b>			
Net income	\$ 5,373,525	\$ 33,931	\$ 5,407,456
Provision for credit losses	10,372	3,092,894	3,103,266
Deferred income taxes	(274,741)	21,044	(253,697)
Amortization of dealer discounts		(3,147,869)	(3,147,869)
Net cash provided by operating activities	8,939,029		8,939,029

In addition the Company has corrected these errors in the finance receivables disclosure in Note 4. The following table sets forth a reconciliation of the changes in the allowance for credit losses on Contracts:

	June 30, 2012 as Reported	Correction	June 30, 2012 as Corrected
Balance at beginning of year	\$ 35,495,684	\$ (15,996,476)	\$ 19,499,208

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Discounts acquired on new volume	3,100,938	(3,100,938)	
Provision for credit losses	(79,218)	3,092,894	3,013,676
Losses absorbed	(3,659,844)		(3,659,844)
Recoveries	788,616		788,616
Discounts accreted	(521)	521	
Balance at end of year	\$ 35,645,655	\$ (16,003,999)	\$ 19,641,656

**2. Revenue Recognition**

Finance receivables consist of purchased automobile finance installment contracts ( Contracts ) and originated 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.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**2. Revenue Recognition (continued)**

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. As of June 30, 2013 and March 31, 2013 the amount of gross finance receivables not accruing interest was approximately \$5,665,000 and \$4,132,000, respectively.

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 lender, 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. The entire amount of discount is amortized as an adjustment to yield using the interest method over the life of the loan. The average dealer discount associated with new volume for the three months ended June 30, 2013 and 2012 was 8.35% and 9.04%, respectively.

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 originating direct loans are recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method.

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.

**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:

	<b>Three months ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
Numerator for earnings per share net income	\$ 5,700,493	\$ 5,407,456
Denominator:		
Denominator for basic earnings per share weighted average shares	12,065,012	11,940,200
Effect of dilutive securities:	222,480	238,640

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

Stock options and other share awards

Denominator for diluted earnings per share	12,287,492	12,178,840
Earnings per share:		
Basic	\$ 0.47	\$ 0.45
Diluted	\$ 0.46	\$ 0.44

For the three months ended June 30, 2013 and 2012 potential common stock from stock options totaling 10,000 and 117,000, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**4. Finance Receivables**

Finance receivables are detailed as follows:

	June 30, 2013	March 31, 2013
Finance receivables, gross contract	\$ 403,447,270	\$ 395,721,730
Unearned interest	(116,076,836)	(112,922,191)
Finance receivables, net of unearned interest	287,370,434	282,799,539
Unearned dealer discounts	(16,709,388)	(16,415,169)
Finance receivables, net of unearned interest and unearned dealer discounts	270,661,046	266,384,370
Allowance for credit losses	(15,403,054)	(16,558,569)
Finance receivables, net	\$ 255,257,992	\$ 249,825,801

The terms of the Contracts range from 12 to 72 months and the Direct Loans range from 6 to 48 months. The Contracts and Direct Loans bear a weighted average effective interest rate of 23.22% and 25.69% as of June 30, 2013 and 23.34% and 25.84% as of March 31, 2013, respectively.

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 June 30,	
	2013	2012
Balance at beginning of period	\$ 16,090,652	\$ 19,499,208
Provision for credit losses	2,494,430	3,013,676
Losses absorbed	(4,648,976)	(3,659,844)
Recoveries	875,067	788,616
Balance at end of period	\$ 14,811,173	\$ 19,641,656

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 June 30, 2013, 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 value of the automobile, is approximately 93%. The Company utilizes a static pool approach to track portfolio performance. If the allowance 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

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

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. In determining the provision and allowance for credit losses, we consider the reduction in the net carrying amount of finance receivables resulting from dealer discounts.

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

	Three months ended	
	June 31,	
	2013	2012
Balance at beginning of period	\$ 467,917	\$ 492,184
Current period provision	147,361	89,590
Losses absorbed	(27,586)	(25,092)
Recoveries	4,189	5,121
Balance at end of period	\$ 591,881	\$ 561,803

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.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**4. Finance Receivables (continued)**

In deciding whether or not to make a Direct 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 June 30, 2013, loans made by the Company pursuant to its Direct Loan program constituted approximately 2% 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.

A performing account is defined as an account that is less than 61 days past due. A non-performing account is defined as an account that is contractually delinquent for 61 days or more and the accrual of interest income is suspended. When an account is 120 days contractually delinquent, the account is written off. Effective April 1, 2013, the Company changed its policy in regards to bankrupt accounts. Prior to April 1, 2013 the Company would charge-off the entire principal balance of a bankrupt account in the month following confirmation from the bankruptcy court. Subsequent to the charge-off the Company would collect monthly payments from the bankruptcy court recording the recovery payments and reducing charge-off totals in the month collected. Under the new method, the Company no longer charges off the entire principal balance at the time of bankruptcy. Upon notification of a bankruptcy, an account is monitored for collection with other bankrupt accounts. In the event the debtors balance has been reduced by the bankruptcy court, the Company will record a loss equal to the amount of principal balance reduction. The remaining balance will be reduced as payments are received by the bankruptcy court. In the event an account is dismissed from bankruptcy, the Company will decide, based on several factors, to begin repossession proceedings to allow the customer to begin making regularly scheduled payments. This approach to bankrupt accounts aligns the Company with typical industry practice. The following table is an assessment of the credit quality by creditworthiness:

	June 30, 2013		March 31, 2013	
	Contracts	Direct Loans	Contracts	Direct Loans
Non-bankrupt accounts	\$ 391,977,580	\$ 9,654,948	\$ 386,324,594	\$ 8,779,270
Bankrupt accounts	1,802,820	11,922	615,499	2,367
<b>Total</b>	<b>\$ 393,780,400</b>	<b>\$ 9,666,870</b>	<b>\$ 386,940,093</b>	<b>\$ 8,781,637</b>
Performing accounts	\$ 388,159,066	\$ 9,623,370	\$ 382,843,130	\$ 8,746,338
Non-performing accounts	5,621,334	43,500	4,096,963	35,299
<b>Total</b>	<b>\$ 393,780,400</b>	<b>\$ 9,666,870</b>	<b>\$ 386,940,093</b>	<b>\$ 8,781,637</b>

The following tables present certain information regarding the delinquency rates experienced by the Company with respect to Contracts and under its Direct Loans:



Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Contracts	Gross Balance Outstanding	Delinquencies				Total	
		31	60 days	61	90 days		Over 90 days
June 30, 2013	\$ 393,780,400	\$ 12,803,342		\$ 3,540,383		\$ 2,080,951	\$ 18,424,676
			3.25%		0.90%	0.53%	4.68%
June 30, 2012	\$ 385,611,683	\$ 12,745,275		\$ 3,216,955		\$ 804,930	\$ 16,767,160
			3.31%		0.83%	0.21%	4.35%
Direct Loans	Gross Balance Outstanding	31	60 days	61	90 days	Over 90 days	Total
June 30, 2013	\$ 9,666,870	\$ 83,885		\$ 27,046		\$ 16,454	\$ 127,385
			0.87%		0.28%	0.17%	1.32%
June 30, 2012	\$ 7,095,917	\$ 78,044		\$ 19,390		\$ 4,226	\$ 101,660
			1.10%		0.27%	0.06%	1.43%

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**5. Line of Credit**

The Company has an agreement with its consortium of lenders for a line of credit facility (the Line ) for an amount of \$150,000,000. In December 2012, the Company executed an amendment to the Line that extends the maturity date to November 30, 2014. The pricing of the Line is 300 basis points above 30-day LIBOR with a 1% floor on LIBOR (4.00% at June 30, 2013 and March 31, 2013). Pledged as collateral for this credit facility are all of the assets of the Company. The outstanding amount of the credit facility was \$126,021,510 and \$125,500,000 as of June 30, 2013 and March 31, 2013, respectively. The amount available under the line of credit was approximately \$23,978,490 and \$24,500,000 as of June 30, 2013 and March 31, 2013, respectively.

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 June 30, 2013, the Company was in full compliance with all debt covenants.

**6. Interest Rate Swap Agreements**

The Company utilizes interest rate swap agreements to manage exposure to variability in expected cash flows attributable to interest rate risk. The interest rate swap agreements 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 swap agreements:

	<b>Three months ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
Notional amounts at April 1	\$ 50,000,000	\$
New contracts		25,000,000
Matured contracts		
Notional amounts at June 30	\$ 50,000,000	\$ 25,000,000

Interest rate swap agreements effective as of June 30, 2013 and during the three months ended June 30, 2013 and 2012 are detailed as follows:

			<b>Fixed Rate</b>	
<b>Date Entered</b>	<b>Effective Date</b>	<b>Notional Amount</b>	<b>Of Interest</b>	<b>Maturity Date</b>
June 1, 2012	June 13, 2012	\$25,000,000	1.00%	June 13, 2017
July 30, 2012	August 13, 2012	\$25,000,000	0.87%	August 14, 2017

The interest rate swap agreements are not designated as hedges. The changes in the fair value of interest of interest rate swaps (unrealized gains and losses) are recorded in earnings. The Company does not use interest rate swap agreements for speculative purposes. Such instruments continue to be intended for use as economic hedges.

The locations and amounts of (gains) losses in income are as follows:

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

	<b>Three months ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
Periodic change in fair value of interest rate swap agreements	\$ (833,259)	\$ 209,101
Periodic settlement differentials included in interest expense	93,314	15,818
<b>Total</b>	<b>\$ (739,945)</b>	<b>\$ 224,919</b>

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

	<b>Three months ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
Variable rate received	0.20%	0.24%
Fixed rate paid	0.94%	1.00%

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**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 estimates the fair value of interest rate swap agreements 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 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.

Description	Fair Value Measurement Using			Fair Value
	Level 1	Level 2	Level 3	
Interest rate swap agreements:				
June 30, 2013	\$	\$ 328,407	\$	\$ 328,407
March 31, 2013	\$	\$ (504,852)	\$	\$ (504,852)

**Financial Instruments Not Measured at Fair Value**

The Company's financial instruments consist of cash, finance receivables and Line. For each of these financial instruments the carrying value approximates fair value.

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 Contracts range from 12 to 72 months. The initial terms of the Direct Loans 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 December 31, 2012. 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 June 30, 2013 was estimated to be equal to the book value. The interest rate for the Line is a variable rate based on LIBOR pricing options.

Description	Fair Value Measurement Using			Fair Value
	Level 1	Level 2	Level 3	
Finance receivables:				
June 30, 2013	\$	\$	\$ 255,257,992	\$ 255,257,992
March 31, 2013	\$	\$	\$ 249,825,801	\$ 249,825,801

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

Line of credit				
June 30, 2013	\$	\$ 126,021,510	\$	\$ 126,021,510
March 31, 2013	\$	\$ 125,500,000	\$	\$ 125,500,000

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.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

**8. Cash Dividend**

Dividends recorded during the three months ended June 30, 2013 and 2012 were declared and paid as follows. On May 7, 2013 the Board of Directors announced a quarterly cash dividend equal to \$0.12 per common share, to be paid on June 28, 2013 to shareholders of record as of June 21, 2013. On May 2, 2012, the Company's Board of Directors announced a quarterly cash dividend of \$0.10 to be paid on June 6, 2012.

Payment of cash dividends results in a 5% withholding tax payable by the Company under the Canada-United States Income Tax Convention which is included in earnings under the caption of dividend tax.

---

**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.

**Strategic Alternatives**

On March 20, 2013, the Company announced that its Board of Directors has retained Janney Montgomery Scott LLC as its independent financial advisor to assist the Board of Directors in evaluating possible strategic alternatives for the Company, including, but not limited to, the possible sale of the Company or certain of its assets, potential acquisition and expansion opportunities, and/or a possible debt or equity financing. The Company also announced that it has received an unsolicited, non-binding indication of interest from a potential third-party acquirer. As of the date of this Report, the Board of Directors is continuing to evaluate possible strategic alternatives and their implications. No assurances can be given as to whether any particular strategic alternative for the Company will be recommended or undertaken or, if so, upon what terms and conditions.

**Corrections to Consolidated Financial Statements**

In connection with the audit of our consolidated financial statements for the fiscal year ended March 31, 2013, the Company determined that it was necessary to correct its consolidated financial statements.

One of the corrections is related to the accounting treatment for dealer discounts. A dealer discount represents the difference between the amount of a finance receivable, net of unearned interest, based on the terms of a Contract with the borrower, and the amount of money the Company actually pays the dealer for the Contract. Prior to the correction, Contracts were recorded at the net initial investment, with the gross Contract balances recorded offset by the dealer discounts which were recorded as an allowance for credit losses for the acquired Contracts. The Company determined that this accounting treatment was incorrect as U.S. GAAP prohibits carrying over valuation allowances in the initial accounting for acquired loans. Accordingly, the Company has now applied an acceptable method under U.S. GAAP, deferring and netting dealer discounts against finance receivables as unearned discounts, and recognizing dealer discounts into income as an adjustment to yield over the life of the each loan using the interest method.

As a result, the allowance for loan losses is now established solely through charges to earnings through the provision for credit losses. The Company has evaluated the significance of the departure from U.S. GAAP to the consolidated financial statements. Under both the former accounting policy and U.S. GAAP, the dealer discount remains a reduction of gross finance receivables in arriving at the carrying amount of finance receivables, net. Accordingly, finance receivables continue to be initially recorded at the net initial investment at the time of purchase. Subsequently, the allowance for credit losses is maintained at an amount that reduces the net carrying amount of finance receivables for incurred losses. The change in this accounting presentation does not result in a change to the net carrying amount of finance receivables or to net income as historical losses incurred, and estimated incurred losses as of the balance sheet date, are generally in excess of the original dealer discount. The removal of the dealer discount from the allowance requires an equal replacement of provision expense as that portion of the allowance is necessary to absorb probable incurred losses. This correction also did not have an impact on previously reported assets, liabilities, working capital, equity, earnings, or cash flows.

The second correction related to the accounting treatment and presentation of certain fees charged to dealers and costs incurred in purchasing loans from dealers. Such costs related principally to evaluating borrowers subject to Contracts in relation to the Company's underwriting

guidelines in making a determination to acquire Contracts. Prior to the correction,



---

**Table of Contents**

fees charged to dealers were reduced by certain costs incurred to purchase Contracts, deferred on a net basis and then amortized into income over the lives of the loans using the interest method. Under U.S. GAAP, the fees charged to dealers are considered to be a part of the unearned dealer discount as they are a determinant of the net amount of cash paid to the dealer. Further, U.S. GAAP specifies that costs incurred in connection with acquiring purchased loans or committing to purchase loans shall be charged to expense as incurred. Such costs do not qualify as origination costs to be deferred as the Contracts have already been originated by the dealers. The Company evaluated the significance of the departure from U.S. GAAP to the consolidated financial statements. After an adjustment to beginning equity and the opening balance of unearned dealer discounts, net of tax, for the initial period presented, there is a limited effect on earnings and no impact on cash flows.

Management corrected the errors and retroactively adjusted amounts as of and for the quarter ended June 30, 2012 to ensure the errors would not result in a material difference in future periods.

The changes to the Company's consolidated financial statements for the quarter ended June 30, 2012 resulting from such corrections are set forth in Note 2. Summary of Significant Accounting Policies - Corrections to the consolidated financial statements of the Company included in Item 1. Financial Statements (Unaudited) of this Report.

Prior period interim financial information appearing elsewhere in this Report has also been revised in light of the foregoing corrections. The changes resulting from such corrections are immaterial and, accordingly, we are not amending or restating any previously filed SEC reports or the consolidated financials included therein.

**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 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 Loans, 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.

The allowance for loan losses is established through charges to earnings through the provision for credit losses. The allowance for credit losses is maintained at an amount that reduces the net carrying amount of finance receivables for incurred losses. If a static pool is fully liquidated and has any remaining reserves, the excess provision is immediately reversed during the period. For static pools that are not fully liquidated that are deemed to have excess reserves, such 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

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

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.

**Table of Contents****Introduction**

Consolidated net income increased 6% to approximately \$5.7 million for the three-month period ended June 30, 2013 as compared to \$5.4 million for the corresponding period ended June 30, 2012. Diluted earnings per share increased to \$0.46 for the three months ended June 30, 2013 from \$0.44 for the three months ended June 30, 2012.

Interest and fee income on finance receivables remained relatively flat for the three months ended June 30, 2013 compared to the three months ended June 30, 2012. Our results for the three months ended June 30, 2013 were positively effected by a non-cash gain related to interest rate swaps and were adversely effected by an increase in operating expenses.

The Company's software subsidiary, Nicholas Data Services, did not contribute significantly to consolidated operations in the three months ended June 30, 2013 or 2012.

<b>Portfolio Summary</b>	<b>Three months ended</b>	
	<b>June 30,</b>	
	<b>2013</b>	<b>2012</b>
Average finance receivables, net of unearned interest (1)	\$ 285,637,997	\$ 279,750,283
Average indebtedness (2)	\$ 125,880,390	\$ 110,750,000
Interest and fee income on finance receivables (3)*	\$ 20,469,372	\$ 20,417,957
Interest expense	1,404,906	1,192,140
Net interest and fee income on finance receivables*	\$ 19,064,466	\$ 19,225,817
Weighted average contractual rate (4)	22.99%	23.81%
Average cost of borrowed funds (2)	4.46%	4.31%
Gross portfolio yield (5)*	28.66%	29.19%
Interest expense as a percentage of average finance receivables, net of unearned interest	1.97%	1.70%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest *	3.70%	4.44%
Net portfolio yield (5)*	22.99%	23.05%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	11.12%	10.10%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)*	11.87%	12.95%
Write-off to liquidation (8)	5.90%	4.93%
Net charge-off percentage (9)	5.15%	4.07%

**Note:** All three 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.

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

- (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.
- (4) Weighted average contractual rate represents the weighted average annual percentage rate ( APR ) of all Contracts purchased and Direct Loans originated during the period.

**Table of Contents**

- (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 \$55,000 and \$67,000 during the three-month periods ended June 30, 2013 and 2012, 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.

\* These amounts for June 30, 2012 have been revised as discussed in Note 2 to the consolidated financial statements.

**Three months ended June 30, 2013 compared to three months June 30, 2012**

**Interest Income and Loan Portfolio**

Interest and fee income on finance receivables, predominately finance charge income, increased by less than 1% to approximately \$20.5 million for the three-month period ended June 30, 2013 from \$20.4 million for the corresponding period ended June 30, 2012. Average finance receivables, net of unearned interest of approximately \$285.6 million as of June 30, 2013, increased 2% from \$279.8 million as of June 30, 2012. 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 recent openings of new branch locations (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 3% to approximately \$403.4 million as of June 30, 2013, from \$392.7 million as of June 30, 2012. The gross portfolio yield decreased to 28.66% for the three-month period ended June 30, 2012 from 29.19% for the three-month period ended June 30, 2012. The net portfolio yield remained fairly consistent at 22.99% for the corresponding period ended June 30, 2013 from 23.05% for the three-month period ended June 30, 2012. The gross portfolio yield decreased due to a lower weighted APR earned on finance receivables.

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

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately \$8.0 million for the three-month period ended June 30, 2013 from approximately \$7.1 million for the corresponding period ended June 30, 2012. The increase of 13% was primarily attributable to new branch locations and an increase in operating expenses. The Company opened additional branches and increased average headcount to 321 for the three-month period ended June 30, 2013 from 303 for the three-month period ended June 30, 2012. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, increased to 11.12% for the three-month period ended June 30, 2013 from 10.10% for the three-month period ended June 30, 2012.

**Interest Expense**

Interest expense increased to approximately \$1.4 million for the three-month period ended June 30, 2013 from \$1.2 million for the three-month period ended June 30, 2012. One interest rate swap agreement was entered into during the first quarter ended June 30, 2012. Two interest rate swap agreements were in effect during the entire three-month period ended June 30, 2013. The following table summarizes the Company's average cost of borrowed funds:

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-Q

	Three months ended	
	June 30,	
	2013	2012
Variable interest under the line of credit facility	0.35%	0.50%
Settlements under interest rate swap agreements	0.30%	0.05%
Credit spread under the line of credit facility	3.81%	3.75%
Average cost of borrowed funds	4.46%	4.30%

The Company's average cost of funds increased due to settlements under the interest rate swap agreements during the three months ended June 30, 2013. The weighted average notional amount of the interest rate swap agreements were \$50.0 million at a weighted average fixed rate of .94% for the three months ended June 30, 2013. As of June 30, 2012 only \$25.0 million in notional interest rate swap agreements was outstanding at a fixed rate of 1.00% and only for a part of the quarter. 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 period ended June 30, 2013 and 2012, less than 1% were for new vehicles.

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

State	Three months ended June 30,	
	2013	2012
FL	\$ 12,109,051	\$ 11,073,393
GA	4,147,343	3,921,042
NC	4,448,482	3,286,300
SC	1,400,374	656,869
OH	6,065,865	5,350,511
MI	1,715,302	1,080,268
VA	1,460,241	1,194,789
IN	2,134,790	1,913,686
KY	2,317,470	2,306,906
MD	519,657	378,245
AL	1,783,268	1,753,764
TN	1,774,514	1,364,078
IL	556,335	1,167,098
MO	1,133,722	1,600,446
KS	316,300	184,537
Total	\$ 41,882,714	\$ 37,231,933

Contracts	Three months ended June 30,	
	2013	2012
Purchases	\$ 41,882,714	\$ 37,231,933
Weighted APR	22.81%	23.67%
Average discount*	8.35%	9.04%
Weighted average term (months)	51	49
Average loan	\$ 10,576	\$ 9,918
Number of Contracts	3,960	3,754

\* This amount for June 30, 2012 has been revised as discussed in Note 2 to the consolidated financial statements.

**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 June 30,	
	2013	2012
Originations	\$ 2,639,159	\$ 2,054,485
Weighted APR	25.82%	26.38%

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

Weighted average term (months)	29	28
Average loan	\$ 3,491	\$ 3,287
Number of loans	756	625

### **Analysis of Credit Losses**

As of June 30, 2013, the Company had 1,372 active static pools. The average pool upon inception consisted of 58 Contracts with aggregate finance receivables, net of unearned interest, of approximately \$595,000.



---

**Table of Contents**

The Company anticipates losses absorbed as a percentage of liquidation will be in the 5%-10% 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 largely on the competition. Other indicators include 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 months ended June 30, 2013.

The provision for credit losses decreased to approximately \$2.6 million from approximately \$3.1 million for the three months ended June 30, 2013 and 2012, respectively. The Company has experienced favorable variances between projected write-offs and actual write-offs on many seasoned pools which has resulted in an increase in expected future cash flows. Accordingly, the amount of additional provision necessary to maintain an adequate allowance to absorb incurred losses in the existing portfolio was less than the provision in fiscal 2013. The Company's losses as a percentage of liquidation increased primarily as a result of increased competition in all markets that the Company presently operates in to 5.90% from 4.93% for the three months ended June 30, 2013 and 2012, respectively. Increased competition has led to a higher percentage of loans acquired that are categorized in the lower tiers of the Company's guidelines. The static pools originated during the three-month period ended June 30, 2013, while still performing at acceptable net charge-off levels, have experienced losses higher than static pools originated during the three-month period ended June 30, 2012. Consequently, if this trend continues, the Company would expect the provision for credit losses to increase for future static pools. The Company has also experienced increased losses in part due to a decrease 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 June 30, 2013 and 2012 auction proceeds from the sale of repossessed vehicles averaged approximately 51% and 57%, respectively of the related principal balance.

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. The delinquency percentage for Contracts more than thirty days past due as of June 30, 2013 was 4.68% as compared to 4.35% as of June 30, 2012. This increase is primarily as a result of increased competition in all markets that the Company presently operates in. Increased competition typically reduces discounts on contracts purchased and also results in a greater percentage of contracts, while still within guidelines, that result in lower credit quality. The delinquency percentage for Direct Loans more than thirty days past due as of June 30, 2013 was 1.32% as compared to 1.43% as of June 30, 2012. See note 4 Finance Receivables for changes in allowance for credit losses, credit quality and delinquencies. Such increases the delinquency percentage for Contracts and the losses as a percentage of liquidation were contemplated in determining the appropriate reserve levels, particularly for less seasoned pools.

Recoveries as a percentage of charge-offs decreased to approximately 21.39% for the three months ended June 30, 2013 from approximately 22.77% for the three months ended June 30, 2012. 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.

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 June 30, 2013 and June 30, 2012 the Company granted deferrals to approximately 5.28% and 5.90%, respectively, of total Contracts. The number of deferrals is influenced by portfolio performance, general economic conditions and the unemployment rate.

**Income Taxes**

Driven by increases in operating income, the provision for income taxes increased to approximately \$3.6 million for the three months ended June 30, 2013 from approximately \$3.4 million for the three months ended June 30, 2012. The Company's effective tax rate remained consistent decreasing slightly to 38.47% for the three months ended June 30, 2013 from 38.48% for the three months ended June 30, 2012.

**Table of Contents****Liquidity and Capital Resources**

The Company's cash flows are summarized as follows:

	Three months ended June 30,	
	2013	2012
Cash provided by (used in):		
Operating activities	\$ 7,688,869	\$ 8,939,029
Investing activities (primarily purchase of Contracts)	(5,766,217)	(2,454,836)
Financing activities	(1,061,417)	(4,237,863)
<b>Net increase in cash</b>	<b>\$ 861,235</b>	<b>\$ 2,246,330</b>

The Company's primary use of working capital during the three months ended June 30, 2013 was the funding of the purchase of Contracts which are financed substantially through cash from operations and draws on the Line. The Line is secured by all of the assets of the Company and has a maturity date of November 30, 2014. 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. As of June 30, 2013, the amount outstanding under the Line was approximately \$126.0 million, and the amount available under the Line was approximately \$24.0 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 increased by approximately \$0.5 million during the three months ended June 30, 2013. The increase of the Line is principally related to the fact that cash needed to fund new contracts exceeded cash received from operations. 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 in compliance with all of its debt covenants.

On May 7, 2013 the Board of Directors announced a quarterly cash dividend equal to \$0.12 per common share, to be paid on June 28, 2013 to shareholders of record as of June 21, 2013.

**Contractual Obligations**

The following table summarizes the Company's material obligations as of June 30, 2013.

	Total	Payments Due by Period			
		Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Operating leases	\$ 3,339,175	\$ 1,614,449	\$ 1,545,984	\$ 178,742	\$
Line of credit	126,021,510		126,021,510		
Interest on line of credit <sup>1</sup>	7,962,459	5,620,559	2,341,900		
<b>Total</b>	<b>\$ 137,323,144</b>	<b>\$ 7,235,008</b>	<b>\$ 129,909,394</b>	<b>\$ 178,742</b>	<b>\$</b>

<sup>1</sup> Interest on outstanding borrowings under the Line as of June 30, 2013 based on an effective interest rate of 4.46% and the estimated effect of the interest rate swap settlement at June 30, 2013. The effective interest rate used in the above table does not contemplate an impact from the

possibility of entering into interest rate swap agreements in the future.

## **Table of Contents**

### **Future Expansion**

The Company currently operates a total of sixty-five branch locations in fifteen states, including twenty in Florida; eight in Ohio; six in North Carolina and Georgia; three in Kentucky, Indiana, Missouri, Michigan, and Alabama; two in Virginia, Tennessee, Illinois, and South Carolina; and one each in Maryland, and Kansas. 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, thirteen 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 2014. 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, 2013, 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: August 9, 2013

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

Date: August 9, 2013

/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>
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.