NICHOLAS FINANCIAL INC
Form 10-Q
November 09, 2015
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, 2015

¨ **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)

British Columbia, Canada	**8736-3354**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
2454 McMullen Booth Road, Building C	
Clearwater, Florida	**33759**
(Address of Principal Executive Offices)	**(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 x 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 x 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	x
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 x

As of October 29, 2015, 12,430,785 shares, no par value, of the Registrant were outstanding (of which 4,713,804 shares were held by the Registrant s principal operating subsidiary and pursuant to applicable law, not entitled to vote and 7,716,981 shares were entitled to vote).

NICHOLAS FINANCIAL, INC.

FORM 10-Q

TABLE O F CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Consolidated Balance Sheets

	September 30, 2015 (Unaudited)	March 31, 2015
Assets		
Cash	$ 1,672,692	$ 3,388,193
Finance receivables, net	308,109,297	288,904,060
Assets held for resale	2,309,206	1,746,887
Income taxes receivable	662,020	112,984
Prepaid expenses and other assets	803,871	1,143,754
Property and equipment, net	1,368,517	872,134
Deferred income taxes	6,400,490	6,360,579
Total assets	$ 321,326,093	$ 302,528,591
Liabilities and shareholders equity		
Line of credit	$ 211,161,315	$ 199,000,000
Drafts payable	1,648,711	2,475,573
Interest rate swap agreements	303,403	180,775
Accounts payable and accrued expenses	7,432,361	7,841,070
Deferred revenues	3,671,174	3,143,231
Total liabilities	224,216,964	212,640,649
Shareholders equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued Common stock, no par: 50,000,000 shares authorized; 12,430,785 and 12,415,785 shares issued, respectively; and 7,716,981 and 7,701,981 shares outstanding, respectively	32,999,984	32,655,130
Treasury stock: 4,713,804 common shares, at cost	(70,459,323)	(70,408,854)
Retained earnings	134,568,468	127,641,666
Total shareholders equity	97,109,129	89,887,942
Total liabilities and shareholders equity	$ 321,326,093	$ 302,528,591

See accompanying notes.

2

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

	Three months ended September 30, 2015	Three months ended September 30, 2014	Six months ended September 30, 2015	Six months ended September 30, 2014
Interest and fee income on finance receivables	$ 22,686,834	$ 21,723,072	$ 44,711,972	$ 43,055,586
Expenses:				
Marketing	364,319	459,389	756,305	862,256
Salaries and employee benefits	5,498,449	5,120,649	11,083,834	10,341,829
Professional Fees	376,559	192,940	824,942	810,788
Administrative	2,501,794	2,473,775	4,852,075	4,849,899
Provision for credit losses	6,177,120	5,154,235	11,166,556	9,386,050
Depreciation	119,009	93,541	213,719	184,124
Interest expense	2,273,215	1,485,193	4,439,623	2,933,778
Change in fair value of interest rate swap agreements	79,066	(251,408)	122,628	(39,121)
	17,389,531	14,728,314	33,459,682	29,329,603
Operating income before income taxes	5,297,303	6,994,758	11,252,290	13,725,983
Income tax expense	2,040,962	2,665,057	4,325,488	4,487,094
Net income	$ 3,256,341	$ 4,329,701	$ 6,926,802	$ 9,238,889
Earnings per share:				
Basic	$ 0.43	$ 0.36	$ 0.91	$ 0.76
Diluted	$ 0.42	$ 0.35	$ 0.89	$ 0.75

See accompanying notes.

3

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	Six months ended September 30, 2015	Six months ended September 30, 2014
Cash flows from operating activities		
Net income	$ 6,926,802	$ 9,238,889
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	213,719	184,124
(Gain) loss on sale of property and equipment	(8,358)	15,739
Provision for credit losses	11,166,556	9,386,050
Amortization of dealer discounts	(6,647,053)	(6,791,907)
Deferred income taxes	(39,911)	113,126
Share-based compensation	261,974	240,290
Change in fair value of interest rate swap agreements	122,628	(39,121)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	364,883	194,192
Accounts payable and accrued expenses	(408,709)	(1,734,262)
Income taxes (receivable) and payable	(549,036)	172,758
Deferred revenues	527,943	386,739
Net cash provided by operating activities	11,931,438	11,366,617
Cash flows from investing activities		
Purchase and origination of finance receivables	(92,755,306)	(80,881,045)
Principal payments received	69,030,566	68,448,279
Increase in assets held for resale	(562,319)	(539,399)
Purchase of property and equipment	(743,744)	(308,948)
Proceeds from sale of property and equipment	42,000	47,450
Net cash used in investing activities	(24,988,803)	(13,233,663)
Cash flows from financing activities		
Net draws on line of credit	12,161,315	4,100,000
Change in drafts payable	(826,862)	(94,071)
Payment of debt costs	(25,000)	
Expenses related to prior purchase of treasury shares	(50,469)	
Proceeds from exercise of stock options	75,946	142,241
Excess tax benefits from share-based compensation	6,934	65,723

Net cash provided by financing activities	11,341,864	4,213,893
Net (decrease) increase in cash	(1,715,501)	2,346,847
Cash, beginning of period	3,388,193	2,635,036
Cash, end of period	$ 1,672,692	$ 4,981,883

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

1. Basis of Presentation

The accompanying consolidated balance sheet as of March 31, 2015, 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, 2016. 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, 2015 as filed with the Securities and Exchange Commission on June 15, 2015. The March 31, 2015 consolidated balance sheet included herein has been derived from the March 31, 2015 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.

2. Revenue Recognition

Finance receivables consist of automobile finance installment contracts (Contracts) and direct consumer loans (Direct Loans). Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan enters bankruptcy status, is contractually delinquent for 60 days or more or the collateral is repossessed, whichever is earlier. Chapter 13 bankrupt accounts are accounted for under the cost-recovery method. Interest income on Chapter 13 bankrupt accounts does not resume until all principal amounts are recovered (see Note 4).

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 six months ended September 30, 2015 and 2014 was 7.55% and 8.16%, respectively in relation to the total amount financed.

Gross finance receivables represent principal balance plus unearned income, excluding unearned income from Chapter 13 bankrupt accounts. 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 involuntary unemployment insurance. These commissions are amortized over the life of the contract using the interest method.

The Company s net costs 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.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

3. Earnings Per Share

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

	Three months ended September 30,		Six months ended September 30,	
	2015	**2014**	**2015**	**2014**
Numerator for earnings per share net income	**$ 3,256,341**	$ 4,329,701	**$ 6,926,802**	$ 9,238,889
Denominator:				
Denominator for basic earnings per share weighted average shares	**7,621,949**	12,190,800	**7,619,136**	12,184,581
Effect of dilutive securities:				
Stock options and other share awards	**130,312**	173,903	**128,722**	186,254
Denominator for diluted earnings per share	**7,752,261**	12,364,703	**7,747,858**	12,370,835
Earnings per share:				
Basic	**$ 0.43**	$ 0.36	**$ 0.91**	$ 0.76
Diluted	**$ 0.42**	$ 0.35	**$ 0.89**	$ 0.75

For the three months ended September 30, 2015 and 2014, potential shares of common stock from stock options totaling 160,217 and 92,663, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive. For the six months ended September 30, 2015 and 2014, potential shares of common stock from stock options totaling 157,623 and 58,989, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive. Please see Note 10 Tender Offer for information regarding the decrease of the weighted average shares for the three and six months ended September 30, 2015.

4. Finance Receivables

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

	September 30, 2015	March 31, 2015
Finance receivables, gross contract	**$ 491,064,286**	$ 457,974,758
Unearned interest	**(152,502,120)**	(139,262,996)
Finance receivables, net of unearned interest	**338,562,166**	318,711,762
Unearned dealer discounts	**(18,719,104)**	(17,779,690)
Finance receivables, net of unearned interest and unearned dealer discounts	**319,843,062**	300,932,072
Allowance for credit losses	**(11,733,765)**	(12,028,012)
Finance receivables, net	**$ 308,109,297**	$ 288,904,060

The terms of the Contracts range from 12 to 72 months and the Direct Loans range from 6 to 60 months. The Contracts and Direct Loans bear a weighted average effective interest rate of 22.77% and 25.81% as of September 30, 2015, respectively and 22.86% and 26.14% as of March 31, 2015, 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.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

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,	
	2015	**2014**	**2015**	**2014**
Balance at beginning of period	**$ 11,523,526**	$ 12,933,905	**$ 11,325,222**	$ 12,889,082
Current period provision	**6,078,219**	5,067,689	**10,964,689**	9,141,087
Losses absorbed	**(7,347,395)**	(7,046,790)	**(12,870,224)**	(11,896,413)
Recoveries	**699,494**	987,890	**1,534,157**	1,808,938
Balance at end of period	**$ 10,953,844**	$ 11,942,694	**$ 10,953,844**	$ 11,942,694

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of September 30, 2015, the average model year of vehicles collateralizing the portfolio was a 2007 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 97%. 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 of the underlying collateral, economic conditions, historical loan loss experience, management s estimate of probable credit losses and other factors that warrant recognition in providing for an adequate allowance for credit losses.

The 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,	
	2015	**2014**	**2015**	**2014**
Balance at beginning of period	**$ 754,757**	$ 706,960	**$ 702,789**	$ 590,278
Current period provision	**98,901**	86,546	**201,867**	244,963

Losses absorbed	**(81,310)**	(65,015)	**(140,286)**	(119,115)
Recoveries	**7,573**	6,009	**15,551**	18,374
Balance at end of period	**$ 779,921**	$ 734,500	**$ 779,921**	$ 734,500

Direct Loans are originated directly between the Company and the consumer. These loans are typically for amounts ranging from $1,000 to $9,000 and are generally secured by a lien on an automobile, watercraft or other permissible tangible personal property. The majority of Direct Loans are originated with current or former customers under the Company s automobile financing program. The typical Direct Loan represents a significantly better credit risk than our typical Contract due to the customer s historical payment history with the Company. In deciding whether or not to make a loan, the Company considers the individual s credit history, job stability, income and impressions created during a personal interview with a Company loan officer. Additionally, because most of Direct Loans made by the Company to date have been made to borrowers under Contracts previously purchased by the Company, the payment history of the borrower under the Contract is a significant factor in making the loan decision. As of September 30, 2015, 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.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

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. Upon notification of a Chapter 13 bankruptcy, an account is monitored for collection with other Chapter 13 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 or to allow the customer to begin making regularly scheduled payments.

The following table is an assessment of the credit quality by creditworthiness:

	September 30, 2015		**September 30, 2014**	
	Contracts	Direct Loans	Contracts	Direct Loans
Performing accounts	**$ 466,911,165**	**$ 11,619,304**	$ 419,111,304	$ 11,268,405
Non-performing accounts	**8,178,141**	**53,891**	8,085,319	101,071
Total	**$ 475,089,306**	**$ 11,673,195**	$ 427,196,623	$ 11,369,476
Chapter 13 bankrupt accounts	**4,268,637**	**33,148**	3,585,641	32,355
Finance receivables, gross contract	**$ 479,357,943**	**$ 11,706,343**	$ 430,782,264	$ 11,401,831

The following tables present certain information regarding the delinquency rates experienced by the Company with respect to Contracts and under its Direct Loans, excluding Chapter 13 bankrupt accounts:

Contracts	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
September 30, 2015	**$ 475,089,306**	**$ 19,746,203**	**$ 5,603,230**	**$ 2,574,911**	**$ 27,924,344**
		4.16%	**1.18%**	**0.54%**	**5.88%**

September 30, 2014	$ 427,196,623	$ 19,923,081	$ 5,241,042	$ 2,844,277	$ 28,008,400
		4.66%	1.23%	0.67%	6.56%

Direct Loans	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
September 30, 2015	**$ 11,673,195**	**$ 156,375**	**$ 27,819**	**$ 26,072**	**$ 210,266**
		1.34%	**0.24%**	**0.22%**	**1.80%**
September 30, 2014	$ 11,369,476	$ 215,570	$ 77,219	$ 23,852	$ 316,641
		1.90%	0.68%	0.21%	2.79%

5. Line of Credit

The Company has a line of credit facility (the Line) up to $225,000,000. The pricing of the Line, which expires on January 30, 2018, is 300 basis points above 30-day LIBOR with a 1% floor on LIBOR (4.00% at September 30, 2015 and March 31, 2015). Pledged as collateral for this Line are all of the assets of the Company. The outstanding amount of the Line was $211,161,315 and $199,000,000 as of September 30, 2015 and March 31, 2015, respectively. The amount available under the Line was approximately $13,838,685 and $26,000,000 as of September 30, 2015 and March 31, 2015, 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 September 30, 2015, the Company was in full compliance with all debt covenants.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

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 convert a portion of the floating rate debt to a fixed rate, more closely matching the interest rate characteristics of finance receivables.

As of the six months ended September 30, 2015 and 2014 no new contracts were initiated and no contracts matured.

The Company currently has two interest rate swap agreements. A June 4, 2012 interest rate swap agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 1% and receives payments from the counterparty on the 1-month LIBOR rate. This interest rate swap agreement had an effective date of June 13, 2012 and a notional amount of $25,000,000. A July 30, 2012 agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 0.87% and receives payments from the counterparty on the 1-month LIBOR rate. This interest rate swap agreement had an effective date of August 13, 2012 and a notional amount of $25,000,000.

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

	Three months ended September 30,		Six months ended September 30,	
	2015	**2014**	**2015**	**2014**
Periodic change in fair value of interest rate swap agreements	**$ 79,066**	$ (251,408)	**$ 122,628**	$ (39,121)
Periodic settlement differentials included in interest expense	**94,525**	99,846	**189,478**	198,838
Total	**$ 173,591**	$ (151,562)	**$ 312,106**	$ 159,717

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

	Three months ended September 30,		Six months ended September 30,	
	2015	**2014**	**2015**	**2014**
Variable rate received	**0.19%**	0.15%	**0.18%**	0.15%

Fixed rate paid	**0.94%**	0.94%	**0.94%**	0.94%

7. Income Taxes

The provision for income taxes decreased to approximately $2.0 million for the three months ended September 30, 2015 from approximately $2.7 million for the three months ended September 30, 2014. The Company s effective tax rate increased to 38.53% for the three months ended September 30, 2015 from 38.10% for the three months ended September 30, 2014. The provision for income taxes decreased to approximately $4.3 million for the six months ended September 30, 2015 from approximately $4.5 million for the six months ended September 30, 2014. The Company s effective tax rate increased to 38.44% for the six months ended September 30, 2015 from 32.69% for the six months ended September 30, 2014. The effective tax rate for the six months ended September 30, 2014 was unusually low due to certain professional fees totaling approximately $1.2 million associated with the potential sale of the Company becoming deductible during the three months ended June 30, 2014 when the Arrangement Agreement was terminated.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. 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.

	Fair Value Measurement Using			
Description	Level 1	Level 2	Level 3	Fair Value
Interest rate swap agreements:				
September 30, 2015 liabilities:	**$**	**$ (303,403)**	**$**	**$ (303,403)**
March 31, 2015 liabilities:	$	$ (180,775)	$	$ (180,775)

Financial Instruments Not Measured at Fair Value

The Company s financial instruments consist of cash, finance receivables and the Line. For finance receivables and the Line 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 60 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.

Based on current market conditions, any new or renewed credit facility would contain pricing that approximates the Company s current Line. Based on these market conditions, the fair value of the Line as of September 30, 2015 was estimated to be equal to the book value. The interest rate for the Line is a variable rate based on LIBOR pricing options.

	Fair Value Measurement Using			
Description	Level 1	Level 2	Level 3	Fair Value
Finance receivables:				
September 15, 2015	**$**	**$**	**$ 308,109,000**	**$ 308,109,000**
March 31, 2015	$	$	$ 288,904,000	$ 288,904,000
Line of credit:				
September, 2015	**$**	**$ 211,161,000**	**$**	**$ 211,161,000**
March 31, 2015	$	$ 199,000,000	$	$ 199,000,000

10

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Fair Value Disclosures (continued)

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.

9. Contingencies

The Company currently is not a party to any pending legal proceedings other than ordinary routine litigation incidental to its business, none of which, if decided adversely to the Company, would, in the opinion of management, have a material adverse effect on the Company s financial condition or results of operations.

10. Tender Offer

On March 19, 2015, the Company announced the final results of the modified Dutch auction tender offer for the purchase of approximately 4.7 million shares of the Company s common shares by its principal operating subsidiary. The tender offer expired on March 13, 2015. Total payments for common shares, including costs were approximately $70,459,000. Such costs were recorded as an increase to treasury stock, reducing shareholders equity.

The aggregate number of common shares purchased in the tender offer by Nicholas represented approximately 38.0% of the Company s outstanding common shares as of March 17, 2015. Following settlement of the tender offer, the Company had approximately 7,701,981 common shares outstanding.

11. Recently Issued Accounting Standards

In April 2015, the FASB issued ASU No. 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. In August 2015, the FASB issued ASU No. 2015-15, since 2015-03 did not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. The SEC staff indicated they would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The amendments are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption of the amendments is permitted. The Company does not believe the adoption of this ASU will have a significant impact on the consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) . The ASU requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. On July 9, 2015, the FASB approved the deferral of the effective date of ASU 2014-09 by one year. As a result, ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The ASU would permit public entities to adopt the ASU early, but not before the original effective date (i.e., annual periods beginning after December 15, 2016). Management has not yet selected a transition method and is currently evaluating the impact of the pending adoption of this ASU on the Company s Consolidated Condensed Financial Statements.

The Company does not believe there are any other recently issued accounting standards that have not yet been adopted that will have a material impact on the Company s consolidated financial statements.

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.

Litigation and Legal Matters

See Item 1. Legal Proceedings in Part II of this quarterly report below.

Regulatory Developments

As previously reported, Title X of the Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB), which became operational on July 21, 2011. Under the Dodd-Frank Act, the CFPB has regulatory, supervisory and enforcement powers over providers of consumer financial products, such as Contracts and the Direct Loans that we offer, including explicit supervisory authority to examine and require registration of installment lenders such as ourselves. Included among the powers afforded to the CFPB is the authority to adopt rules describing specified acts and practices as being unfair, deceptive or abusive, and hence unlawful. Although the Dodd-Frank Act expressly provides that the CFPB has no authority to establish usury limits, some consumer advocacy groups have suggested that certain forms of alternative consumer finance products, such as installment loans, should be a regulatory priority and it is possible that at some time in the future the CFPB could propose and adopt rules making such lending or other products that we may offer materially less profitable or impractical. Further, the CFPB may target specific features of loans by rulemaking that could cause us to cease offering certain products. Any such rules could have a material adverse effect on our business, results of operation and financial condition. The CFPB could also adopt rules imposing new and potentially burdensome requirements and limitations with respect to any of our current or future lines of business, which could have a material adverse effect on our operations and financial performance.

The CFPB recently issued rules regarding the supervision and examination of non-depository larger participants in the automobile finance business, including us. Since we are deemed a larger participant, we are subject to supervision and examination by the CFPB. The CFPB s stated objectives of such examinations are: to assess the quality of a larger participant s compliance management systems for preventing violations of federal consumer financial laws; to identify acts or practices that materially increase the risk of violations of federal consumer finance laws and associated harm to consumers; and to gather facts that help determine whether the larger participant engages in acts or practices that are likely to violate federal consumer financial laws in connection with its automobile finance business. Thus, as a larger participant, we will be subject to examination by the CFPB for, among other things, ECOA compliance; unfair, deceptive or abusive acts or practices (UDAAP) compliance; and the adequacy of our compliance management systems.

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 incurred 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 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 probable 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 Contracts in the static pool, and current market and economic conditions. Each static pool is analyzed monthly to determine if the loss reserves are adequate, and adjustments are made if they are determined to be necessary.

Introduction

Diluted net earnings increased 20% to $0.42 for the three-month period ended September 30, 2015 as compared to $0.35 for the corresponding period ended September 30, 2014. Net earnings were $3,256,000 and $4,329,000 for the three months ended September 30, 2015 and 2014, respectively. Revenue increased 4% to $22,687,000 for the three months ended September 30, 2015 as compared to $21,723,000 for the three months ended September 30, 2014. Diluted net earnings increased 19% to $0.89 for the six-month period ended September 30, 2015 as compared to $0.75 for the corresponding period ended September 30, 2014. Net earnings were $6,927,000 and $9,239,000 for the six months ended September 30, 2015 and 2014, respectively. Revenue increased 4% to $44,712,000 for the six months ended September 30, 2015 as compared to $43,056,000 for the six months ended September 30, 2014.

Our net earnings for the three months ended September 30, 2015 were adversely affected by a reduction in the gross portfolio yield, and an increase in the provision for losses, which are primarily the result of increased competition. Our net earnings were also adversely affected by a change in the fair value of interest rate swap agreements and an increase in interest expense when compared to the corresponding period ended September 30, 2014. Our per share diluted net earnings for the three months ended September 30, 2015, were positively impacted by the Company s purchase of 4.7 million of the Company s common shares by its principal operating subsidiary on March 19, 2015.

Our net earnings for the six months ended September 30, 2015 were adversely affected by a reduction in the gross portfolio yield and an increase in the provision for losses, which are primarily the result of increased competition. Our net earnings were also adversely affected by an increase in interest expense when compared to the corresponding period ended September 30, 2014. Our per share diluted net earnings for the six months ended September 30, 2015, were positively impacted by the Company s purchase of 4.7 million of the Company s common shares by its principal operating subsidiary on March 19, 2015. Our net earnings for the six months ended September 30, 2014 were also positively affected by a decrease in income tax expense of $804,000 or $0.07 per share. This reduction related to

Table of Contents

professional fees associated with the previously announced potential sale of the Company that were not initially deductible for income tax purposes, but became deductible as a result of the termination of the Arrangement Agreement as announced on July 1, 2014.

	Three months ended September 30,		Six months ended September 30,	
Portfolio Summary	**2015**	**2014**	**2015**	**2014**
Average finance receivables, net of unearned interest (1) Average Net Finance Receivables (1)	$ 334,700,913	$ 309,836,832	$ 329,627,741	$ 307,376,210
Average indebtedness (2)	$ 207,446,179	$ 132,350,000	$ 204,275,011	$ 131,093,750
Interest and fee income on finance receivables	$ 22,686,834	$ 21,723,073	$ 44,711,972	$ 43,055,586
Interest expense	2,273,215	1,485,192	4,439,623	2,933,778
Net interest and fee income on finance receivables	$ 20,413,619	$ 20,237,881	$ 40,272,349	$ 40,121,808
Weighted average contractual rate (3)	22.84%	23.10%	22.84%	23.10%
Average cost of borrowed funds (2)	4.38%	4.49%	4.35%	4.48%
Gross portfolio yield (4)	27.11%	28.04%	27.13%	28.01%
Interest expense as a percentage of average finance receivables, net of unearned interest	2.72%	1.92%	2.69%	1.91%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	7.38%	6.65%	6.78%	6.11%
Net portfolio yield (4)	17.01%	19.47%	17.66%	19.99%
Marketing, salaries, employee benefits, depreciation, administrative and professional fee expenses as a percentage of average finance receivables, net of unearned interest (5)	10.59%	10.77%	10.76%	11.09%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (6)	6.42%	8.70%	6.90%	8.90%
Write-off to liquidation (7)	9.64%	9.01%	8.34%	7.77%

Net charge-off percentage (8)	8.03%	7.89%	6.95%	6.63%

Note: All three-month 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) Weighted average contractual rate represents the weighted average annual percentage rate (APR) of all Contracts and Direct Loans as of the period ending date.

(4) 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.

(5) The numerators for the three and six months ended September 30, 2014 include expenses associated with the potential sale of the Company. Absent these expenses, the percentages would have been 10.72% and 10.86%, respectively.

(6) Pre-tax yield represents net portfolio yield minus administrative expenses (marketing, salaries, employee benefits, depreciation, administrative, and professional fees) as a percentage of average finance receivables, net of unearned interest.

(7) Write-off to liquidation percentage is defined as net charge-offs divided by liquidation. Liquidation is defined as beginning gross receivable balance plus current period purchases minus voids and refinances minus ending gross receivable balance.

(8) 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, 2015 compared to three months September 30, 2014

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 4.6% to approximately $22.7 million for the three-month period ended September 30, 2015 from $21.7 million for the corresponding period ended September 30, 2014. Average finance receivables, net of unearned interest equaled approximately $334.7 million for the three-month period ended September 30, 2015, an increase of 8.0% from $309.8 million for the corresponding period ended September 30, 2014. The primary reason average finance receivables, net of unearned interest increased was the increase of the receivable base of several existing branches in younger markets (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 11.1% to approximately $491.1 million as of September 30, 2015, from $442.2 million as of September 30, 2014. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 27.11% for the three-month period ended September 30, 2015 compared to 28.04% for the three-month period ended September 30, 2014. The gross portfolio yield decreased primarily due to the decrease in the average dealer discount and a decrease in the average APR, which is primarily the result of increased competition. The average dealer discount associated with new volume for the three months ended September 30, 2015 and 2014 was 7.57% and 8.18%, respectively in relation to the total amount financed. The net portfolio yield decreased to 17.01% for the three-month period ended September 30, 2015 from 19.47% for the corresponding period ended September 30, 2014. The net portfolio yield decreased due to a decrease in the gross portfolio yield, an increase in the provision for credit losses, and an increase in interest expense (see Analysis of Credit Losses and Interest Expense below).

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

Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses increased to approximately $8.9 million for the three-month period ended September 30, 2015 from approximately $8.3 million for the corresponding period ended September 30, 2014. The increase was primarily related to an increase in costs associated with maintaining the finance receivable portfolio. The Company increased average headcount to 340 for the three-month period ended September 30, 2015 from 326 for the three-month period ended September 30, 2014. Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.59% for the three-month period ended September 30, 2015 from 10.77% for the three-month period ended September 30, 2014. The three months ended September 30, 2014 calculation includes expenses associated with the potential sale of the Company. Absent these expenses, the percentage would have been 10.72%.

Interest Expense

Interest expense increased to approximately $2.3 million for the three-month period ended September 30, 2015 from $1.5 million for the three-month period ended September 30, 2014. The following table summarizes the Company s average cost of borrowed funds:

	Three months ended September 30,	
	2015	**2014**
Variable interest under the line of credit facility	**0.39%**	0.31%
Settlements under interest rate swap agreements	**0.18%**	0.30%
Credit spread under the line of credit facility	**3.81%**	3.88%

Average cost of borrowed funds	**4.38%**	4.49%

The Company s average cost of funds decreased mostly due to the interest rate swap agreements not increasing proportionately to total average debt as of September 30, 2015 as compared to September 30, 2014. The total average debt increased in March 2015 due to the tender offer. LIBOR rates have also increased, which has caused the credit spread to decrease and the variable interest to increase. The variable interest rate also includes a decrease in the unused line fees offset with an increase in amortized debt fees.

The notional amount of interest rate swap agreements was $50.0 million at a weighted average fixed rate of 0.94% for each of the three-month periods ended September 30, 2015 and 2014. For further discussions regarding the effect of interest rate swap agreements see Note 6 Interest Rate Swap Agreements .

Table of Contents

Six months ended September 30, 2015 compared to six months September 30, 2014

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 4.0% to approximately $44.7 million for the six-month period ended September 30, 2015 from $43.0 million for the corresponding period ended September 30, 2014. Average finance receivables, net of unearned interest equaled approximately $329.6 million for the six-month period ended September 30, 2015, an increase of 7.2% from $307.4 million for the corresponding period ended September 30, 2014. The primary reason average finance receivables, net of unearned interest increased was the increase of the receivable base of several existing branches in younger markets (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 11.1% to approximately $491.1 million as of September 30, 2015, from $442.2 million as of September 30, 2014. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 27.13% for the six-month period ended September 30, 2015 compared to 28.01% for the six-month period ended September 30, 2014. The gross portfolio yield decreased primarily due to the decrease in the average dealer discount and a decrease in the average APR, which is primarily the result of increased competition. The average dealer discount associated with new volume for the six months ended September 30, 2015 and 2014 was 7.55% and 8.16%, respectively in relation to the total amount financed. The net portfolio yield decreased to 17.66% for the six-month period ended September 30, 2015 from 19.99% for the corresponding period ended September 30, 2014. The net portfolio yield decreased due to a decrease in the gross portfolio yield, an increase in the provision for credit losses, and an increase in interest expense (see Analysis of Credit Losses and Interest Expense below).

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

Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses increased to approximately $17.7 million for the six-month period ended September 30, 2015 from approximately $17.0 million for the corresponding period ended September 30, 2014. The increase was primarily related to an increase in costs associated with maintaining the finance receivable portfolio. The Company increased average headcount to 338 for the six-month period ended September 30, 2015 from 326 for the six-month period ended September 30, 2014. Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.76% for the six-month period ended September 30, 2015 from 11.09% for the three-month period ended September 30, 2014. The six months ended September 30, 2014 calculation includes expenses associated with the potential sale of the Company. Absent these expenses, the percentage would have been 10.86%.

Interest Expense

Interest expense increased to approximately $4.4 million for the six-month period ended September 30, 2015 from $2.9 million for the six-month period ended September 30, 2014. The following table summarizes the Company s average cost of borrowed funds:

	Six months ended September 30,	
	2015	**2014**
Variable interest under the line of credit facility	**0.35%**	0.30%
Settlements under interest rate swap agreements	**0.19%**	0.30%
Credit spread under the line of credit facility	**3.81%**	3.88%

Average cost of borrowed funds	**4.35%**	4.48%

The Company s average cost of funds decreased mostly due to the interest rate swap agreements not increasing proportionately to total average debt as of September 30, 2015 as compared to September 30, 2014. The total average debt increased in March 2015 due to the tender offer. LIBOR rates have also increased, which has caused the credit spread to decrease and the variable interest to increase. The variable interest rate also includes a decrease in the unused line fees offset with an increase in amortized debt fees.

The notional amount of interest rate swap agreements was $50.0 million at a weighted average fixed rate of 0.94% for each of the six-month periods ended September 30, 2015 and 2014. 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 sixteen states listed in the table below. The Contracts purchased by the Company are predominately for used vehicles; for the three- and six-month periods ended September 30, 2015 and 2014, less than 1% were for new vehicles.

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