NICHOLAS FINANCIAL INC
Form 10-Q
February 14, 2007
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 DECEMBER 31, 2006**

¨ **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 is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

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 January 31, 2007, the registrant had 9,962,381 shares of common stock outstanding.

Table of Contents

NICHOLAS FINANCIAL, INC.

FORM 10-Q

TABLE OF CONTENTS

Part I. Financial Information		**Page**
Item 1.	Financial Statements (Unaudited)	
	Condensed Consolidated Balance Sheets as of December 31, 2006 and as of March 31, 2006	3
	Condensed Consolidated Statements of Income for the three and nine months ended December 31, 2006 and 2005	4
	Condensed Consolidated Statements of Cash Flows for the nine months ended December 31, 2006 and 2005	5
	Notes to the Condensed Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	13
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	24
Item 4.	Controls and Procedures	24
Part II. Other Information		
Item 1A	Risk Factors	24
Item 6.	Exhibits	24

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	December 31, 2006 (Unaudited)	March 31, 2006
Assets		
Cash	$ 2,146,082	$ 1,729,057
Finance receivables, net	156,045,342	140,197,738
Accounts receivable	28,725	11,638
Assets held for resale	1,169,950	790,224
Prepaid expenses and other assets	869,115	570,723
Property and equipment, net	1,010,403	887,832
Derivatives	918,551	1,601,089
Deferred income taxes	3,758,984	3,706,642
Total assets	$ 165,947,152	$ 149,494,943
Liabilities		
Line of credit	$ 90,828,592	$ 82,415,917
Drafts payable	783,924	992,171
Accounts payable and accrued expenses	5,984,503	6,064,734
Income taxes payable		177,557
Deferred revenues	1,541,034	1,595,389
Total liabilities	99,138,053	91,245,768
Shareholders equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued and outstanding		
Common stock, no par: 50,000,000 shares authorized; 9,962,381 and 9,912,931 shares issued and outstanding, respectively	15,942,303	15,525,988
Accumulated other comprehensive income	568,623	992,675
Retained earnings	50,298,173	41,730,512
Total shareholders equity	66,809,099	58,249,175
Total liabilities and shareholders equity	$ 165,947,152	$ 149,494,943

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	2006	**2005**	**2006**	**2005**
Revenue:				
Interest income on finance receivables	$ 11,706,733	$ 11,065,071	$ 34,575,726	$ 30,372,675
Sales	23,496	42,177	90,111	133,684
	11,730,229	11,107,248	34,665,837	30,506,359
Expenses:				
Cost of sales	3,955	15,123	9,357	37,407
Marketing	293,550	345,277	914,937	890,126
Salaries and employee benefits	2,763,136	2,916,558	8,572,655	8,229,528
Administrative	1,453,602	1,061,235	4,104,966	3,215,706
Provision for credit losses	1,193,778	1,172,108	2,856,231	2,432,142
Depreciation	91,030	86,342	269,972	242,601
Interest expense	1,451,647	1,122,358	4,074,541	3,161,390
	7,250,698	6,719,001	20,802,659	18,208,900
Operating income before income taxes	4,479,531	4,388,247	13,863,178	12,297,459
Income tax expense:				
Current	1,558,867	1,771,348	5,089,373	4,951,761
Deferred	150,870	(101,431)	206,144	(275,636)
	1,709,737	1,669,917	5,295,517	4,676,125
Net income	$ 2,769,794	$ 2,718,330	$ 8,567,661	$ 7,621,334
Earnings per share:				
Basic	$ 0.28	$ 0.28	$ 0.86	$ 0.77
Diluted	$ 0.27	$ 0.26	$ 0.83	$ 0.73

See accompanying notes.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended December 31,	
	2006	2005
Cash flows from operating activities		
Net income	$ 8,567,661	$ 7,621,334
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	269,972	242,601
Gain on sale of property and equipment	(22,889)	(14,366)
Provision for credit losses	2,856,231	2,432,142
Deferred income taxes	206,144	(275,636)
Share-based compensation	251,952	
Changes in operating assets and liabilities:		
Accounts receivable	(17,087)	4,565
Prepaid expenses and other assets	(298,392)	(55,948)
Accounts payable and accrued expenses	(80,231)	724,037
Income taxes payable	(177,557)	(473,322)
Deferred revenues	(54,355)	203,627
Net cash provided by operating activities	11,501,449	10,409,034
Cash flows from investing activities		
Purchase and origination of finance contracts	(81,027,913)	(75,321,061)
Principal payments received	62,324,080	53,558,398
Increase in assets held for resale	(379,726)	(369,647)
Purchase of property and equipment	(441,681)	(319,937)
Proceeds from sale of property and equipment	72,027	14,366
Net cash used in investing activities	(19,453,215)	(22,437,881)
Cash flows from financing activities		
Repayment of notes payable related party		(400,000)
Net proceeds from line of credit	8,412,675	13,066,068
Decrease in drafts payable	(208,247)	(38,657)
Proceeds from exercise of stock options and income tax benefit related thereto	164,363	218,855
Net cash provided by financing activities	8,368,791	12,846,266
Net increase in cash	417,025	817,419
Cash, beginning of period	1,729,057	853,494
Cash, end of period	$ 2,146,082	$ 1,670,913

See accompanying notes.

5

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2006, which has been derived from audited financial statements, and the accompanying unaudited interim condensed consolidated financial statements of Nicholas Financial, Inc. (including its subsidiaries, the Company) have been prepared in accordance with accounting principles generally accepted in the United States 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 accounting principles generally accepted in the United States for complete financial statements, although the Company believes that the disclosures made are adequate to make the information not misleading. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending March 31, 2007. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and accompanying notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006 as filed with the Securities and Exchange Commission on June 29, 2006.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Certain amounts in our prior-period condensed consolidated financial statements and notes have been reclassified to conform to the current-period presentation.

2. Revenue Recognition

The Company is principally a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales Contracts (Contracts) for purchases of new and used automobiles and light trucks. To a lesser extent, the Company also makes direct loans and sells consumer-finance related products.

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.

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 entire amount of discount is related to credit quality and is considered to be part of the credit loss reserve. The Company receives a commission for selling add-on services to consumer borrowers and amortizes the commission, net of the related costs, over the term of the loan using the interest method. The Company s net fees charged for processing a loan are recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method.

The amount of future unearned income is computed as the product of the Contract rate, the Contract term, and the Contract amount. The Company aggregates the Contracts purchased during a three-month period for each of its branch locations. After the analysis of purchase date accounting is complete, any uncollectible amounts would be contemplated in the allowance for credit losses.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(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 December 31,		Nine months ended December 31,	
	2006	2005	2006	2005
Numerator for earnings per share net income	$ 2,769,794	$ 2,718,330	$ 8,567,661	$ 7,621,334
Denominator:				
Denominator for basic earnings per share weighted average shares	9,934,559	9,875,864	9,927,019	9,866,288
Effect of dilutive securities:				
Stock options and other share awards	365,585	585,756	361,422	604,094
Denominator for diluted earnings per share	10,300,144	10,461,620	10,288,441	10,470,382
Earnings per share basic	$ 0.28	$ 0.28	$ 0.86	$ 0.77
Earnings per share diluted	$ 0.27	$ 0.26	$ 0.83	$ 0.73

4. Finance Receivables

Finance receivables consist of automobile finance installment Contracts and direct consumer loans and are detailed as follows:

	December 31, 2006	March 31, 2006
Finance receivables, gross contract	$ 244,044,574	$ 222,718,384
Unearned interest	(67,132,251)	(59,952,624)
Finance receivables, net of unearned interest	176,912,323	162,765,760
Dealer discounts	(10,533,033)	(13,629,445)
Allowance for credit losses	(10,333,948)	(8,938,577)
Finance receivables, net	$ 156,045,342	$ 140,197,738

The terms of the receivables range from 12 to 72 months and bear a weighted average interest rate of 24% for the three and nine months ended December 31, 2006.

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

5. Line of Credit

At December 31, 2006 the Company had an $100.0 million line of credit facility (the Line) expiring on November 30, 2008. The Company may borrow the lesser of $100.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. As of December 31, 2006, $89.0 million of borrowings under the Line used LIBOR plus 175.0 basis points pricing options. The remainder of the borrowings under the Line used the prime rate plus 37.5 basis points pricing option. The prime rate based borrowings are generally less than $5.0 million. The Company s cost of borrowed funds, which is based upon the interest rates charged under the Line, related party debt and the effect of the interest rate swap agreements (see note 7), amounted to 6.53% and 6.34% for the three and nine months ended December 31, 2006, respectively, as compared to 5.85% and 5.90% for the three and nine month period ended December 31, 2005, respectively. Pledged as collateral for this credit facility are all of the assets of the Company s subsidiary, Nicholas Financial, Inc. As of December 31, 2006, the amount outstanding under the Line was approximately $90.8 million and the amount available under the Line was approximately $9.2 million. 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 require consent in writing by the agent and majority lenders under the facility. As of December 31, 2006, the Company was in full compliance with all debt covenants.

6. Notes Payable Related Party

The Company had unsecured notes payable to the President and Chief Executive Officer at December 31, 2005 totaling $600,000. For the three and nine months ended December 31, 2005 the notes bore a variable interest rate equal to the average cost of borrowed funds for the Company plus 25.0 basis points, 6.15% at December 31, 2005. The Company incurred interest expense on the above notes of approximately $9,400 and $29,800 for the three and nine months ended December 31, 2005, respectively. The interest rate was recalculated every three months and the notes were due upon thirty-day demand. The notes were called in on February 7, 2006 and paid in full on March 9, 2006.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

7. Derivatives and Hedging

The Company utilizes interest rate swap agreements to manage interest rate exposure. The swaps effectively convert a portion of the Company s floating rate debt to a fixed rate, more closely matching the interest rate characteristics of the Company s finance receivables. At December 31, 2006, $50,000,000 of the Company s borrowings have been designated as the hedged items to interest rate swap agreements which are detailed as follows:

Date Entered	Effective Date	Notional Amount	Fixed Rate Of Interest	Maturity Date
January 6, 2003	April 2, 2003	$ 10,000,000	3.35%	April 2, 2007
February 26, 2003	May 17, 2004	$ 10,000,000	3.91%	May 19, 2008
March 11, 2004	October 5, 2004	$ 10,000,000	3.64%	October 5, 2009
January 18, 2005	July 5, 2005	$ 10,000,000	4.38%	July 2, 2010
September 9, 2005	September 13, 2005	$ 10,000,000	4.46%	September 2, 2010

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk, such as interest rate risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of the future cash flows of the hedged item, if any, is recognized in current earnings during the period of change.

Each swap agreement has identical terms to the critical terms of the hedged item and meets each condition in Statement of Financial Accounting Standards (SFAS) No.133 for utilization of the short-cut method to assess the effectiveness of the swap agreement in hedging the variability of interest payments on the floating rate borrowings under the Line. The short-cut method presumes there is no hedge ineffectiveness if all such applicable conditions are met and the critical terms of the hedge and the hedged item do not change. During the life of each hedge, the critical terms of the hedge and the hedged item did not change. Accordingly, the Company did not have any gain or loss from hedge ineffectiveness.

The Company records net gains and losses from the swap agreements into the interest expense line item of the consolidated statement of income. Under the swap agreements, the Company received an average variable rate of 5.33% and 4.08% for the three months ended December 31, 2006 and 2005, respectively. During the same periods the Company paid an average fixed rate of 3.95% and 3.82%, respectively. Under the swap agreements, the Company received an average variable rate of 5.20% and 3.58% for the nine months ended December 31, 2006 and 2005, respectively. During the same periods the Company paid an average fixed rate of 3.89% and 3.72%, respectively. The interest rate swaps are recorded at fair value, approximately $919,000 and $1,601,000 as of December 31 and March 31, 2006, respectively, in the caption derivatives on the condensed consolidated balance sheet. Accumulated other comprehensive income at December 31 and March 31, 2006 of approximately $569,000 and $993,000, respectively, represents the after-tax effect of the derivative gains.

The following table reconciles net income with comprehensive income.

	Three months ended December 31,		Nine months ended December 31,	
	2006	2005	2006	2005
Net Income	$ 2,769,794	$ 2,718,330	$ 8,567,661	$ 7,621,334

Mark to market interest rate swaps, net of tax benefit (expense) of $30,776, ($115,467), $258,486 and ($149,863), respectively	(49,959)	188,393	(424,052)	244,485
Comprehensive income	$ 2,719,835	$ 2,906,723	$ 8,143,609	$ 7,865,819

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

8. Share-Based Payments

The Company has share awards outstanding under three share-based compensation plans (the Equity Plans). Under the 1998 Employee Stock Option Plan and Non-Employee Director Stock Option Plan (collectively the 1998 Plans) the Board of Directors was authorized to grant option awards for up to 1,410,000 common shares to employees and directors. On August 9, 2006 the Company s shareholders approved the Nicholas Financial, Inc. Equity Incentive Plan (the 2006 Plan) for employees and non-employee directors. Under the 2006 Plan the Board of Directors is authorized to grant total share awards for up to 975,000 common shares. The 2006 Plan replaced the 1998 Plans; accordingly no additional option awards may be granted under the 1998 Plans. In addition to option awards, the 2006 Plan provides for restricted stock and performance share awards.

Option awards previously granted to employees and directors under the 1998 Plans generally vest ratably based on service over a five and three-year period, respectively and generally have a contractual term of 10 years. Vesting and contractual terms for option awards under the 2006 Plan are essentially the same as those of the 1998 Plans. Restricted stock awards generally cliff vest over a three-year period based on service conditions. The vesting of performance share awards is contingent upon the attainment of company-wide performance goals including annual revenue growth and operating income targets. There are no post-vesting restrictions for share awards.

The Company funds share awards from authorized but unissued shares and does not purchase shares to fulfill the obligations of the plans. Dividends, if any, are not paid on unvested performance shares or unexercised options, but are paid on unvested restricted stock awards.

Effective April 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payments , hereafter referred to as SFAS No. 123(R), which revises SFAS No. 123, Accounting for Stock Based Compensation, and supersedes Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, and its related interpretations. SFAS No. 123(R) requires recognition of the cost of employee services received in exchange for an award of equity instruments in the consolidated financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). SFAS No. 123(R) also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award. SFAS No. 123(R) also amends SFAS No. 95 Statement of Cash Flows, to require that excess tax benefits be reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows.

The Company adopted SFAS No. 123(R) using the modified prospective application. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Prior to the adoption of SFAS No. 123(R), the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company s common stock on the date of grant.

The Company estimates the fair market value of each option award using the Black-Scholes option pricing model. The risk-free interest rate is based upon a U.S. Treasury instrument with a life that is similar to the expected term of the options. Expected volatility is based upon the historical volatility for the previous period equal to the expected term of the options. The expected term is based upon the average life of previously issued options. The expected dividend yield is based upon the current yield on date of grant.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

8. Share-Based Payments (continued)

A summary of share award activity under the Equity Plans as of December 31, 2006, and changes during the nine-month period then ended is presented below.

	Share Awards	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2006	756,200	$ 2.78		
Granted	39,000	$		
Exercised	(25,450)	$ 2.37		
Forfeited	(16,850)	$ 7.34		
Outstanding at December 31, 2006	752,900	$ 2.54	3.87	$ 6,968,330
Exercisable at December 31, 2006	621,550	$ 2.00	3.03	$ 6,092,670

The Company granted 39,000 and 48,000 share awards with a fair value of $13.95 and $4.84 during the nine months ended December 31, 2006 and 2005, respectively. The total intrinsic value of options exercised during the nine months ended December 31, 2006 and 2005 was approximately $272,000 and $386,000, respectively.

Cash received from options exercised during the nine months ended December 31, 2006 and 2005 totaled approximately $60,000 and $63,000, respectively. Related income tax benefits during the same periods totaled approximately $104,000 and $156,000, respectively. Such amounts are included in proceeds from exercise of stock options and income tax benefit related thereto under cash flows from financing activities in the condensed consolidated statements of cash flows.

During the nine months ended December 31, 2006, 16,850 options were forfeited at exercise prices ranging from $2.20 to $10.35 per share. During the same period 25,450 options were exercised at exercise prices ranging from $1.13 to $10.35 per share.

The following table presents a summary of the status of non-vested share awards under the Equity Plans as of December 31, 2006, and changes during the nine-month period then ended.

	Share Awards	Weighted Average Grant Date Fair Value
Non-vested at March 31, 2006	151,850	$ 2.80
Granted	39,000	$ 13.95
Vested	(42,650)	$ 2.19
Forfeited	(16,850)	$ 3.17

Non-vested at December 31, 2006	131,350	$	6.26

Table of Contents

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

8. Share-Based Payments (continued)

As of December 31, 2006 there was approximately $557,000 of unrecognized compensation cost related to non-vested awards granted under the Equity Plans, which is expected to be recognized over a weighted-average period of approximately 3 years.

For purposes of disclosure pursuant to SFAS No. 123 and for recognition pursuant to SFAS No. 123(R) the estimated fair value of share awards is amortized over the awards requisite service period (the vesting period) using the straight line method. The adoption of SFAS No. 123(R) and its fair value compensation cost recognition provisions are different from the nonrecognition provisions under SFAS No. 123 and the intrinsic value method for compensation cost allowed by APB No. 25. For the nine months ended December 31, 2006 total compensation cost for share-based payments recognized in income and the tax benefit related thereto were approximately $252,000 and $96,000, respectively. The adoption of SFAS No. 123(R) decreased reported amounts as follows for the nine months ended December 31, 2006.

Operating income before income taxes	$(251,952)
Net income	$ (155,580)
Earnings per share:	
Basic	$ (0.02)
Diluted	$ (0.02)

The following table illustrates the effect on net income and earning per share if the Company had applied the fair value recognition provision of SFAS No. 123(R) to options granted under the plans to the three and nine-month periods ended December 31, 2005. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes option pricing model and amortized to expense over the award s vesting period.

	Three months ended December 31, 2005	Nine months ended December 31, 2005
Reported net income	$ 2,718,330	$ 7,621,334
Fair value impact of stock-based compensation not reported in net income, net of tax	13,183	40,369
Pro forma net income	$ 2,705,147	$ 7,580,965
Earnings per share:		
Reported basic	$ 0.28	$ 0.77
Pro forma basic	$ 0.27	$ 0.77

Reported diluted	$	0.26	$	0.73
Pro forma diluted	$	0.26	$	0.72

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 degree and nature of competition, demand for consumer financing in the markets served by the Company, the Company s products and services, increases in the default rates experienced on Contracts, adverse regulatory changes in the Company s existing and future markets, the Company s ability to expand its business, including its ability to complete acquisitions and integrate the operations of acquired businesses, to recruit and retain qualified employees, to expand into new markets and to maintain profit margins in the face of increased pricing competition. All forward looking statements included in this report are based on information available to the Company on the date hereof, and the Company assumes no obligations to update any such forward looking statement. You should also consult factors described from time to time in the Company s filings made with the Securities and Exchange Commission, including its reports on Form 10-K, 10-Q, 8-K and annual reports to shareholders.

Critical Accounting Policy

The Company s critical accounting policy relates to the allowance for losses on loans. It is based on management s opinion of an amount that is adequate to absorb losses in the existing portfolio. The allowance for credit losses is established through allocations of dealer discount and, for loans acquired prior to April 1, 2005, a portion of unearned income and a provision for loss based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans and current economic conditions. Such evaluation, which includes a review of all loans on which full collectibility may not be reasonably assured, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management s estimate of probable credit losses and other factors that warrant recognition in providing for an adequate credit loss allowance.

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

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

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

Table of Contents

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

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

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

Introduction

Consolidated net income increased to $2.8 million for the three-month period ended December 31, 2006 as compared to $2.7 million for corresponding period ended December 31, 2005. Consolidated net income increased to $8.6 million for the nine-month period ended December 31, 2006 as compared to $7.6 million for corresponding period ended December 31, 2005. Earnings were favorably impacted by an increase in the outstanding loan portfolio. The Company s software subsidiary, Nicholas Data Services (NDS), did not contribute significantly to consolidated operations in the three or nine months ended December 31, 2006 or 2005.

Table of Contents

Portfolio Summary	Three months ended December 31, 2006	2005	Nine months ended December 31, 2006	2005
Average finance receivables, net of unearned interest (1) Average Net Finance Receivables (1)	$ 174,444,124	$ 153,011,496	$ 169,638,227	$ 146,526,954
Average indebtedness (2)	$ 88,950,919	$ 76,791,186	$ 85,716,061	$ 71,499,601
Finance revenue (3)	$ 11,706,731	$ 11,065,071	$ 34,575,726	$ 30,372,375
Interest expense	1,451,647	1,122,358	4,074,541	3,161,390
Net finance revenue	$ 10,255,086	$ 9,942,713	$ 30,501,185	$ 27,210,985
Weighted average contractual rate (4)	23.78%	23.99%	23.95%	24.01%
Average cost of borrowed funds (2)	6.53%	5.85%	6.34%	5.90%
Gross portfolio yield (5)	26.84%	28.93%	27.18%	27.64%
Interest expense as a percentage of average finance receivables, net of unearned interest	3.33%	2.93%	3.20%	2.88%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	2.74%	3.06%	2.24%	2.21%
Net portfolio yield (5)	20.77%	22.94%	21.74%	22.55%
Operating expenses as a percentage of average finance receivables, net of unearned interest (6)	10.46%	11.41%	10.80%	11.27%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	10.31%	11.53%	10.94%	11.28%
Write-off to liquidation (8)	7.96%	6.19%	6.91%	5.92%
Net charge-off percentage (9)	7.38%	5.47%	6.47%	5.28%

Note: All three and nine 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 and notes payable-related party. Average cost of borrowed funds represents interest expense as a percentage of average indebtedness.

(3) Finance revenue does not include revenue generated by NDS. See Computer Software Business caption below for details on NDS revenue during the period.

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

(5) Gross portfolio yield represents finance revenues as a percentage of average finance receivables, net of unearned interest. Net portfolio yield represents finance revenue minus (a) interest expense and (b) the provision for credit losses as a percentage of average finance receivables, net of unearned interest.

(6) Operating expenses represent total expenses, less interest expense, the provision for credit losses and operating costs associated with NDS. See Computer Software Business caption below for details on NDS operating expenses during the period.

(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.

15

Table of Contents

Three months ended December 31, 2006 compared to three months ended December 31, 2005

Interest Income and Loan Portfolio

Interest income on finance receivables, predominately finance charge income increased 6% to approximately $11.7 million for the three-month period ended December 31, 2006, from $11.1 million for the corresponding period ended December 31, 2005. Average finance receivables, net of unearned interest equaled approximately $174.4 million for the three-month period ended December 31, 2006, an increase of 14% from $153.0 million for the corresponding period ended December 31, 2005. The primary reason average finance receivables, net of unearned interest increased was the increase in the receivable base of several existing branches. The gross finance receivable balance increased 16% to approximately $244.0 million at December 31, 2006 from $211.2 million at December 31, 2005. The primary reason interest income increased was the increase in the outstanding loan portfolio.

The gross portfolio yield decreased from 28.93% for the three-month period ended December 31, 2005 to 26.84% for the three-month period ended December 31, 2006. Reserves accreted into income for the three-month period ended December 31, 2006 were approximately $911,000 as compared to $2.1 million for the corresponding period ended December 31, 2005.

The net portfolio yield decreased from 22.94% for the three-month period ended December 31, 2005 to 20.77% for the corresponding period ended December 31, 2006. The net portfolio yield decrease is primarily attributable to the decrease in the gross portfolio yield.

The provision was approximately $1.2 million for each three-month period ended December 31, 2006 and 2005. There were no provisions reversed for the three-month periods ended December 31, 2006 and December 31, 2005.

Computer Software Business

Sales for the three-month period ended December 31, 2006 were approximately $23,000 as compared to $42,000 for the corresponding period ended December 31, 2005, a decrease of 45%. This decrease was primarily due to lower revenue from the existing customer base during the period ended December 31, 2006. Cost of sales and operating expenses decreased to approximately $46,000 for the three-month period ended December 31, 2006 from $61,000 for the three-month period ended December 31, 2005. The primary reason for the decrease was the reduction in the number of employees during the respective periods. Three of the remaining five employees of Nicholas Data Services were re-allocated to the Company s finance subsidiary, Nicholas Financial.

Operating Expenses

Operating expenses, excluding provision for credit losses, interest expense and costs associated with NDS, increased to approximately $4.6 million for the three-month period ended December 31, 2006 from $4.4 million for the corresponding period ended December 31, 2005. This increase of 5% was primarily attributable to the additional staffing of several existing branches, increased general operating expenses and the opening of additional branch offices. Operating expenses as a percentage of finance receivables, net of unearned interest decreased to 10.46% for the three-month period ended December 31, 2006 from 11.41% for the three-month period ended December 31, 2005. The primary reason for the decrease was the increase in average finance receivables, net of unearned interest.

Interest Expense

Interest expense increased to approximately $1.5 million for the three-month period ended December 31, 2006 from $1.1 million for the three-month period ended December 31, 2005. The average indebtedness for the three-month period ended December 31, 2006 increased to approximately $89.0 million as compared to $76.8 million for the corresponding period ended December 31, 2005. The Company s average cost of borrowed funds increased to 6.53% for the three-month period ended December 31, 2006 as compared to 5.85% for the corresponding period ended December 31, 2005. The primary reasons for this increase was the percentage of the Company s debt that is subject to variable interest rates was greater during the three months ended December 31, 2006 as compared to the three months ended December 31, 2005 and the variable rate benchmark (30-day libor) is greater this year versus last year.

Table of Contents

Nine months ended December 31, 2006 compared to nine months ended December 31, 2005

Interest Income and Loan Portfolio

Interest income on finance receivables, predominately finance charge income increased 14% to approximately $34.6 million for the nine-month period ended December 31, 2006, from $30.4 million for the corresponding period ended December 31, 2005. Average finance receivables, net of unearned interest equaled approximately $169.6 million for the nine-month period ended December 31, 2006, an increase of 16% from $146.5 million for the corresponding period ended December 31, 2005. The primary reason average finance receivables, net of unearned interest increased was the increase in the receivable base of several existing branches and the opening of additional branch locations. The gross finance receivable balance increased 16% to approximately $244.0 million at December 31, 2006 from $211.2 million at December 31, 2005. The primary reason interest income increased was the increase in the outstanding loan portfolio.

The gross portfolio yield decreased from 27.64% for the nine-month period ended December 31, 2005 to 27.18% for the nine-month period ended December 31, 2006. Reserves accreted into income for the nine-month period ended December 31, 2006 were approximately $3.3 million as compared to $5.7 million for the corresponding period ended December 31, 2005.

The net portfolio yield decreased from 22.55% for the nine-month period ended December 31, 2005 to 21.74% for the corresponding period ended December 31, 2006. The provision was approximately $2.9 million for the nine-month period ended December 31, 2006 and approximately $2.4 million for the corresponding period ended December 31, 2005. Provisions reversed for the nine-month period ended December 31, 2006, which totaled approximately $617,000. No provisions were reversed during the nine months ended December 31, 2005. The reversal of provisions previously recorded was due to the charge-off performance of static pools originated from April 2005 through September 2005.

Computer Software Business

Sales for the nine-month period ended December 31, 2006 were approximately $90,000 as compared to $134,000 for the corresponding period ended December 31, 2005, a decrease of 33%. This decrease was primarily due to lower revenue from the existing customer base during the period ended December 31, 2006. Cost of sales and operating expenses decreased to approximately $132,000 for the nine-month period ended December 31, 2006 from $231,000 for the nine-month period ended December 31, 2005. The primary reason for the decrease was the reduction in the number of employees during the respective periods. Three of the remaining five employees of Nicholas Data Services were re-allocated to the Company s finance subsidiary, Nicholas Financial.

Operating Expenses

Operating expenses, excluding provision for credit losses, interest expense and costs associated with NDS, increased to approximately $13.7 million for the nine-month period ended December 31, 2006 from $12.4 million for the corresponding period ended December 31, 2005. This increase of 10% was primarily attributable to the additional staffing of several existing branches, increased general operating expenses and the opening of additional branch offices. Operating expenses as a percentage of finance receivables, net of unearned interest decreased to 10.80% for the nine-month period ended December 31, 2006 from 11.27% for the nine-month period ended December 31, 2005. The primary reason for the decrease was the increase in average finance receivables, net of unearned interest.

Interest Expense

Interest expense increased to approximately $4.1 million for the nine-month period ended December 31, 2006 from $3.2 million for the nine-month period ended December 31, 2005. The average indebtedness for the nine-month period ended December 31, 2006 increased to approximately $85.7 million as compared to $71.5 million for the corresponding period ended December 31, 2005. The Company s average cost of borrowed funds increased to 6.34% for the nine-month period ended December 31, 2006 as compared to 5.90% for the corresponding period ended December 31, 2005. The primary reasons for this increase was the percentage of the Company s debt that is subject to variable interest rates was greater during the nine months ended December 31, 2006 as compared to the nine months ended December 31, 2005 and the variable rate benchmark (30-day libor) is greater this year versus last year.

Table of Contents

Contract Procurement

The Company purchases Contracts in the eleven states listed in the table below. The Company has been expanding its Contract procurement in Florida, Ohio, North Carolina, Georgia, Virginia, Kentucky, South Carolina, Maryland, Michigan, Indiana and Alabama. See Future Expansion below. The Contracts purchased by the Company are predominately for used vehicles; for the three and nine month periods ended December 31, 2006 and 2005, less than 3% were new. As of December 31, 2006, the average model year of vehicles collateralizing the portfolio was 2000.

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

State	Three months ended December 31,		Nine months ended December 31,	
	2006	2005	2006	2005
FL	$ 12,410,354	$ 11,691,315	$ 39,429,480	$ 36,522,349
GA	2,916,940	2,500,377	8,034,792	7,252,928
NC	3,024,486	3,069,148	9,328,922	8,971,810
SC	1,132,544	957,810	2,810,928	2,823,183
OH	3,059,850	3,195,775	9,603,298	9,642,396
MI	491,898	727,318	1,314,090	1,727,396
VA	1,927,412	1,793,698	5,264,673	5,463,363
IN	875,071	774,614	1,937,198	2,026,819
KY	1,945,599	1,162,032	4,463,092	2,278,537
MD	991,385	826,508	2,831,028	1,477,224
AL				