NICHOLAS FINANCIAL INC
Form 10-Q
February 16, 2010
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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, 2009**

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ______ TO ______.**

Commission file number: 0-26680

NICHOLAS FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

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 ¨ No ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company 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, 2010, the registrant had 11,717,220 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	December 31, 2009 (Unaudited)	March 31, 2009
Assets		
Cash	$ 4,768,686	$ 1,732,575
Finance receivables, net	197,439,850	186,694,369
Assets held for resale	1,428,567	1,058,481
Prepaid expenses and other assets	740,886	717,131
Property and equipment, net	699,671	774,472
Deferred income taxes	7,460,395	6,805,147
Total assets	$ 212,538,055	$ 197,782,175
Liabilities		
Line of credit	$ 110,369,917	$ 102,030,195
Drafts payable	846,599	975,240
Accounts payable and accrued expenses	5,019,879	5,553,680
Income taxes payable	16,681	206,451
Deferred revenues	1,125,802	1,244,136
Interest rate swaps	1,174,187	2,754,760
Total liabilities	118,553,065	112,764,462
Shareholders equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 11,717,220 and 11,411,214 shares issued and outstanding, respectively (adjusted for stock dividend)	25,446,186	18,073,622
Accumulated other comprehensive loss	(272,227)	(755,919)
Retained earnings	68,811,031	67,700,010
Total shareholders equity	93,984,990	85,017,713
Total liabilities and shareholders equity	$ 212,538,055	$ 197,782,175

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

	Three months ended December 31, 2009	Three months ended December 31, 2008	Nine months ended December 31, 2009	Nine months ended December 31, 2008
Revenue:				
Interest and fee income on finance receivables	$ 14,354,022	$ 13,239,373	$ 42,166,002	$ 39,830,500
Sales	11,020	14,927	50,474	48,221
	14,365,042	13,254,300	42,216,476	39,878,721
Expenses:				
Cost of sales	5,868	3,060	11,840	12,491
Marketing	311,718	310,163	931,966	985,601
Salaries and employee benefits	3,632,115	3,303,807	10,654,209	10,138,462
Administrative	1,759,117	1,666,277	5,581,730	5,407,952
Provision for credit losses	3,019,586	4,567,640	9,596,501	13,115,044
Depreciation	79,190	91,090	244,293	270,594
Interest expense	1,079,044	1,268,669	3,645,282	4,109,682
Change in fair value of interest rate swaps	(264,501)	1,664,220	(796,883)	1,664,220
	9,622,137	12,874,926	29,868,938	35,704,046
Operating income before income taxes	4,742,905	379,374	12,347,538	4,174,675
Income tax expense	1,833,767	144,469	4,742,499	1,590,234
Net income	$ 2,909,138	$ 234,905	$ 7,605,039	$ 2,584,441
Earnings per share:				
Basic (adjusted for stock dividend)	$ 0.25	$ 0.02	$ 0.67	$ 0.23
Diluted (adjusted for stock dividend)	$ 0.25	$ 0.02	$ 0.65	$ 0.23

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended December 31, 2009	Nine months ended December 31, 2008
Cash flows from operating activities		
Net income	$ 7,605,039	$ 2,584,441
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	244,293	270,594
Gain on sale of property and equipment	(10,032)	(16,763)
Provision for credit losses	9,596,501	13,115,044
Deferred income taxes	(955,246)	(2,161,595)
Share-based compensation	354,754	511,906
Change in fair value of interest rate swaps	(796,883)	1,664,220
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(23,755)	74,690
Accounts payable and accrued expenses	(533,801)	(580,962)
Income taxes payable	(189,770)	1,037,166
Deferred revenues	(118,334)	(203,858)
Net cash provided by operating activities	15,172,766	16,294,883
Cash flows from investing activities		
Purchase and origination of finance contracts	(79,318,221)	(75,894,747)
Principal payments received	58,976,239	58,320,906
Increase in assets held for resale	(370,086)	(289,603)
Purchase of property and equipment	(169,492)	(257,544)
Proceeds from sale of property and equipment	10,032	25,755
Net cash used in investing activities	(20,871,528)	(18,095,233)
Cash flows from financing activities		
Net proceeds from line of credit	8,339,722	1,592,824
Decrease in drafts payable	(128,641)	(580,080)
Proceeds from exercise of stock options	260,956	193,056
Net excess tax benefits related to exercise of stock options	262,836	192,235
Net cash provided by financing activities	8,734,873	1,398,035
Net increase (decrease) in cash	3,036,111	(402,315)
Cash, beginning of period	1,732,575	2,297,451
Cash, end of period	$ 4,768,686	$ 1,895,136

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2009, which has been derived from audited financial statements, and the accompanying unaudited interim condensed consolidated financial statements of Nicholas Financial, Inc. (including its subsidiaries, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q pursuant to the Securities and Exchange Act of 1934, as amended in Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements, although the Company believes that the disclosures made are adequate to make the information not misleading. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending March 31, 2010. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and accompanying notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2009 as filed with the Securities and Exchange Commission on June 15, 2009. The March 31, 2009 condensed consolidated balance sheet included herein has been derived from the March 31, 2009 audited consolidated balance sheet included in the aforementioned Form 10-K.

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

On November 10, 2009 the Board of Directors declared a 10% stock dividend on December 7, 2009 to shareholders of record on November 20, 2009. As a result of this stock dividend, an entry of approximately $6.5 million was made to reflect the re-capitalization of shareholders equity from retained earnings to common stock. This amount was derived from the quoted market value of the shares at the date of declaration ($6.10) times the number of shares issued as a result of the 10% stock dividend. All references in the condensed consolidated financial statements and notes to the number of shares outstanding, per share amounts, and share awards of the Company s common shares have been restated to reflect the effect of the stock dividend for all periods presented.

2. Revenue Recognition

Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan is contractually delinquent for 60 days or more or the collateral is repossessed, whichever is earlier.

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

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

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

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

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Earnings Per Share (adjusted for stock dividend)

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

	Three months ended December 31,		Nine months ended December 31,	
	2009	2008	2009	2008
Numerator for earnings per share net income	$ 2,909,138	$ 234,905	$ 7,605,039	$ 2,584,441
Denominator:				
Denominator for basic earnings per share weighted average shares	11,510,017	11,285,097	11,399,565	11,253,683
Effect of dilutive securities:				
Stock options and other share awards	214,624	130,550	217,719	151,646
Denominator for diluted earnings per share	11,724,641	11,415,647	11,617,284	11,405,329
Earnings per share:				
Basic	$ 0.25	$ 0.02	$ 0.67	$ 0.23
Diluted	$ 0.25	$ 0.02	$ 0.65	$ 0.23

For the three and nine months ended December 31, 2009 potential common stock from stock options totaling 273,900 and 312,400, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

4. Finance Receivables

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

	December 31, 2009	March 31, 2009
Finance receivables, gross contract	$ 316,282,215	$ 297,925,475
Unearned interest	(89,829,740)	(85,791,963)
Finance receivables, net of unearned interest	226,452,475	212,133,512
Allowance for credit losses	(29,012,625)	(25,439,143)
Finance receivables, net	$ 197,439,850	$ 186,694,369

The terms of the receivables range from 12 to 72 months and bear a weighted average interest rate of approximately 23.3% as of December 31, 2009.

5. Line of Credit

The Company has a $115.0 million line of credit facility (the Line), which expires on November 30, 2010. The Company may borrow the lesser of the $115.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options plus 162.5 basis points or at the prime rate. Prime rate based borrowings are generally less than $5.0 million. The Company s cost of borrowed funds, which is based upon the interest rates charged under the Line and the effect of the interest rate swap agreements (see note 6), amounted to 3.92% and 4.57% for the three and nine month periods ended December 31, 2009, respectively, as compared to 4.87% and 5.28% for the three and nine month periods ended December 31, 2008, respectively. Pledged as collateral for this credit facility are all of the assets of the Company. As of December 31, 2009 the outstanding amount of the credit facility was approximately $110.4 million and the amount available under the Line was approximately $4.6 million. The Line requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Cash dividends require consent in writing by the agent and majority lenders under the facility. As of December 31, 2009, the Company was in full compliance with all debt covenants. See note 9 Subsequent Events regarding the new credit agreement and increase of amounts available under the Line from $115.0 million to $140.0 million.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements

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

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

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

	Nine months ended December 31, 2009	Nine months ended December 31, 2008
Notional amounts at April 1	$ 80,000,000	$ 80,000,000
New contracts		10,000,000
Matured contracts	(30,000,000)	(10,000,000)
Notional amounts at December 31	$ 50,000,000	$ 80,000,000

As of December 31, 2009 and March 31, 2009, the Company had interest rate swaps comprising an aggregate notional amount of $50,000,000 and $80,000,000, respectively, which are detailed as follows:

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

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

The locations and amounts of gains (losses) recognized in income during the three and nine months ended December 31, 2009 are as follows:

Location	Three months ended December 31,	Nine months ended December 31
Interest expense	$ (541,000)	$ (2,030,000)
Change in fair value of interest rate swaps	$ 265,000	$ 797,000

During the three and nine months ended December 31, 2009, approximately $199,000 and $784,000 of unrealized losses were reclassified from accumulated other comprehensive loss to the change in fair value of interest rate swaps line item of the consolidated statement of income. At December 31, 2009 remaining accumulated other comprehensive loss, net of tax, was approximately $272,000. Prospective amounts expected to be reclassified and affect net earnings are $94,000 during the remainder of fiscal 2010 and $178,000 during fiscal 2011.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements (continued)

In addition, the changes in the fair value of interest rate swaps for the three and nine months ended December 31, 2009 of approximately $464,000 and $1,581,000, respectively, were recorded in the change in fair value of interest rate swaps line item of the consolidated statement of income.

The Company records net realized gains and losses from the swap agreements into the interest expense line item of the consolidated statement of income. Such settlement payments approximated $541,000 and $226,000 for the three months ended December 31, 2009 and 2008, respectively. Such settlement payments approximated $2,030,000 and $829,000 for the nine months ended December 31, 2009 and 2008, respectively.

Under the swap agreements, the Company received an average variable rate of 0.24% and 2.89% and paid an average fixed rate of 3.91% and 4.01% for the three months ended December 31, 2009 and 2008, respectively. Under the swap agreements, the Company received an average variable rate of 0.32% and 2.67% and paid an average fixed rate of 3.98% and 4.03% for the nine months ended December 31, 2009 and 2008, respectively. The interest rate swap liabilities are recorded at fair value, which is approximately $1,174,000 and $2,755,000 as of December 31, 2009 and March 31, 2009, respectively, in the interest rate swaps line item of the consolidated balance sheets. Accumulated other comprehensive loss as of December, 31, 2009 and March 31, 2009 of approximately $272,000 and $756,000, respectively, represents the after-tax effect of changes in the fair value of interest rate swaps prior to October 2008 when the swaps were designated and qualifying as cash flow hedges. As noted above, these changes in fair value, which were previously recorded in accumulated other comprehensive loss while interest rate swaps were designated as cash flow hedges, are reclassified into earnings as interest payments on the Line affect earnings over the remaining term of the respective swap agreements.

The following table reconciles net income with comprehensive income.

	Three months ended December 31,		Nine months ended December 31,	
	2009	**2008**	**2009**	**2008**
Net income	$ 2,909,138	$ 234,905	$ 7,605,039	$ 2,584,441
Change in fair value of interest rate swaps, net of tax benefit (expense) of $366,572 and ($311,323)		(591,036)		501,955
Reclassification adjustment for loss included in net income, net of tax benefit of $76,072, $106,986, and $299,998, $106,986, respectively.	122,652	172,497	483,692	172,497
Comprehensive income	$ 3,031,790	$ (183,634)	$ 8,088,731	$ 3,258,893

7. Fair Value Disclosures

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

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

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

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

7. Fair Value Disclosures (continued)

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

Effective April 1, 2009, the Company adopted recent provisions of ASC 825, *Financial Instruments*, broadening the disclosures about the fair value of financial instruments to interim financial reporting. The adoption did not have a significant impact on the consolidated financial statements. The Company s financial instruments consist of cash, finance receivables, accrued interest, the Line, interest rate swap agreements and accounts payable. For each of these financial instruments, excluding the Line, the carrying value is, or approximates, fair value. The carrying value of cash and cash equivalents approximates the fair value due to the nature of these accounts. Finance receivables, net approximates fair value based on the price paid to acquire indirect loans. The price paid reflects competitive market interest rates and purchase discounts for the Company s chosen credit grade in the economic environment. This market is highly liquid as the Company acquires individual loans on a daily basis from dealers. The initial terms of the indirect finance receivables range from 12 to 72 months. The initial terms of the direct finance receivables range from 6 to 48 months. There have been minimal changes in interest rates and purchase discounts related to these types of loans. If liquidated outside of the normal course of business, the amount received may not be the carrying value. Accrued interest is paid monthly. As a result of the short term nature of accrued interest and accounts payable, the carrying values approximate fair value. The interest rate for the Line is a variable rate based on LIBOR pricing options or at the prime rate. Any new or renewed credit facility would contain pricing that is materially higher than the Company s current Line. Based on market conditions, the fair value of the Line was estimated to be $108,500,000 and $98,800,000 as of December 31, 2009 and March 31, 2009, respectively.

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

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

	Fair Value Measurement Using			Assets/Liabilities Measured at Fair Value
Description	**Level 1**	**Level 2**	**Level 3**	
Interest rate swap agreements:				
December 31, 2009	**$**	**$ 1,174,187**	**$**	**$ 1,174,187**
March 31, 2009	$	$ 2,754,760	$	$ 2,754,760

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

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

8. Other Recently Issued Accounting Standards

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

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

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

9. Subsequent Events

The Company has evaluated subsequent events through February 12, 2010 which is the date that the condensed consolidated financial statements were issued. Pursuant to the requirements of FASB ACS Topic 855, Subsequent Events , there was one event that occurred during this subsequent event reporting period that requires further recognition and disclosure in the financial statements. On January 12, 2010 the Company announced that the Company has executed a new agreement with its consortium of lenders that increases the size of the Line from $115 million to $140 million, subject to formulas principally related to a percentage of eligible finance receivables, as defined. The pricing of the new agreement is 300 basis points above 30-day Libor with a 1% floor on Libor. The Line requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Cash dividends require consent in writing by the agent and majority lenders under the facility.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Information

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

Critical Accounting Policy

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

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

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

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

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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 for credit losses is used to reestablish adequate reserves. If a static pool is fully liquidated and has any remaining reserves, the excess discounts are immediately recognized into income and the excess provision is immediately reversed during the period. For static pools not fully liquidated that are determined to have excess discounts, such excess amounts are accreted into income over the remaining life of the static pool. For static pools not fully liquidated that are deemed to have excess reserves, such excess amounts are reversed against provision for credit losses during the period.

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

Introduction

Consolidated net income increased to approximately $2.9 million for the three-month period ended December 31, 2009 as compared to $235,000 for the corresponding period ended December 31, 2008. Net income for the three months ended December 31, 2009 and 2008 includes a pre-tax gain of approximately $265,000 and a pre-tax charge of $1.7 million respectively, related to the change in fair value of interest rate swaps. Consolidated net income increased to approximately $7.6 million for the nine-month period ended December 31, 2009 as compared to $2.6 million for the corresponding period ended December 31, 2008. Net income for the nine months ended December 31, 2009 and 2008 includes a pre-tax gain of approximately $797,000 and a pre-tax charge of $1.7 million respectively, related to the change in fair value of interest rate swaps. Other than pre-tax gains related to the change in fair value of interest rate swaps, earnings were favorably impacted primarily by an increase in the average net receivables, a decrease in operating expenses as a percentage of average finance receivables, net of unearned interest, a reduction in the provision for credit losses and a decrease in the average cost of borrowed funds. The Company s software subsidiary, Nicholas Data Services (NDS), did not contribute significantly to consolidated operations in the three and nine months ended December 31, 2009 or 2008, respectively.

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

For the three months ended December 31, 2009, net earnings, excluding changes in fair value of interest rate swaps (non-GAAP), increased 108% to $2.7 million compared to $1.3 million for the three months ended December 31, 2008. Per share diluted net earnings, excluding changes in fair value of interest rate swaps (non-GAAP), increased 109% to $0.23 for the three months ended December 31, 2009 as compared to $0.11 for the three months ended December 31, 2008.

For the nine months ended December 31, 2009, net earnings, excluding changes in fair value of interest rate swaps, increased 97% to $7.1 million compared to $3.6 million for the nine months ended December 31, 2008. Per share diluted net earnings, excluding changes in fair value of interest rate swaps, increased 91% to $0.61 for the nine months ended December 31, 2009 as compared to $0.32 for the nine months ended December 31, 2008.

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

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Reconciliation of Non-GAAP Financial Measures

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

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

	Three months ended December 31,		Nine months ended December 31,	
	2009	**2008**	**2009**	**2008**
Net income, GAAP	$ 2,909,138	$ 234,905	$ 7,605,039	$ 2,584,441
Mark-to-market (gain) loss on interest rate swaps, net of tax expense (benefit) of $102,265, ($632,316), and $306,070, ($632,316), respectively	(162,236)	1,031,904	(490,813)	1,031,904
Net earnings, excluding changes in fair value of interest rate swaps **(a)**	$ 2,746,902	$ 1,266,809	$ 7,114,226	$ 3,616,345

	Three months ended December 31,		Nine months ended December 31,	
	2009	**2008**	**2009**	**2008**
Diluted earnings per share, GAAP	$ 0.25	$ 0.02	$ 0.65	$ 0.23
Per diluted share mark-to-market (gain) loss on interest rate swaps	$ (0.02)	$ 0.09	$ (0.04)	$ 0.09
Per share diluted net earnings, excluding changes in fair value of interest rate swaps **(a)**	$ 0.23	$ 0.11	$ 0.61	$ 0.32

(adjusted for stock dividend)

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

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Portfolio Summary

	Three months ended December 31, 2009	Three months ended December 31, 2008	Nine months ended December 31, 2009	Nine months ended December 31, 2008
Average finance receivables, net of unearned interest (1)	$ 226,321,020	$ 208,438,920	$ 221,581,423	$ 206,814,055
Average indebtedness (2)	$ 110,060,915	$ 104,109,909	$ 106,465,014	$ 103,705,519
Finance revenue (3)	$ 14,354,022	$ 13,239,373	$ 42,166,002	$ 39,830,500
Interest expense	1,079,044	1,268,669	3,645,282	4,109,682
Net finance revenue	$ 13,274,978	$ 11,970,704	$ 38,520,720	$ 35,720,818
Weighted average contractual rate (4)	23.41%	23.90%	23.60%	24.17%
Average cost of borrowed funds (2)	3.92%	4.87%	4.57%	5.28%
Gross portfolio yield (5)	25.37%	25.41%	25.37%	25.68%
Interest expense as a percentage of average finance receivables, net of unearned interest	1.91%	2.43%	2.19%	2.65%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	5.34%	8.77%	5.77%	8.46%
Net portfolio yield (5)	18.12%	14.21%	17.41%	14.57%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	10.12%	10.22%	10.38%	10.67%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	8.00%	3.99%	7.03%	3.90%
Write-off to liquidation (8)	11.27%	14.62%	11.07%	12.90%
Net charge-off percentage (9)	8.39%	11.15%	8.12%	10.27%

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. Average cost of borrowed funds represents interest expense as a percentage of average indebtedness.
(3) Finance revenue represents interest and fee income on finance receivables and does not include revenue generated by Nicholas Data Services, Inc., (NDS) the wholly-owned software subsidiary of Nicholas Financial, Inc.
(4) Weighted average contractual rate represents the weighted average annual percentage rate (APR) of all Contracts purchased and direct loans originated during the period.
(5) Gross portfolio yield represents finance revenues as a percentage of average finance receivables, net of unearned interest. Net portfolio yield represents finance revenue minus (a) interest expense and (b) the provision for credit losses as a percentage of average finance

receivables, net of unearned interest.

(6) Administrative expenses included in the calculation above are net of administrative expenses associated with NDS which approximated $55,000 and $48,000 during the three-month periods ended December 31, 2009 and 2008 and $164,000 and $259,000 during the nine-month periods ended December 31, 2009 and 2008, respectively.

(7) Pre-tax yield represents net portfolio yield minus marketing, salaries, employee benefits, depreciation and administrative 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.

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Three months ended December 31, 2009 compared to three months ended December 31, 2008

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 9% to approximately $14.4 million for the three-month period ended December 31, 2009 from $13.2 million for the corresponding period ended December 31, 2008. Average finance receivables, net of unearned interest equaled approximately $226.3 million for the three-month period ended December 31, 2009, an increase of 9% from $208.4 million for the corresponding period ended December 31, 2008. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and the opening of one additional branch location. The gross finance receivable balance increased 9% to approximately $316.3 million as of December 31, 2009, from $291.5 million as of December 31, 2008. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 25.41% for the three-month period ended December 31, 2008 to 25.37% for the three-month period ended December 31, 2009. The net portfolio yield increased from 14.21% for the three-month period ended December 31, 2008 to 18.12% for the corresponding period ended December 31, 2009. The gross portfolio yield decreased primarily due to a lower weighted annual percentage rate (APR) earned on finance receivables. The net portfolio yield increased primarily due to a decrease in the average cost of borrowed funds and a reduction in the provision for credit losses.

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

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $5.8 million for the three-month period ended December 31, 2009 from approximately $5.4 million for the corresponding period ended December 31, 2008. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.12% for the three-month period ended December 31, 2009 from 10.22% for the three-month period ended December 31, 2008.

Interest Expense

Interest expense decreased to approximately $1.1 million for the three-month period ended December 31, 2009 from $1.3 million for the three-month period ended December 31, 2008. The average indebtedness for the three-month period ended December 31, 2009 increased to approximately $110.1 million as compared to $104.1 million for the corresponding period ended December 31, 2008. The Company s average cost of borrowed funds decreased to 3.92% for the three-month period ended December 31, 2009 as compared to 4.87% for the corresponding period ended December 31, 2008. The weighted-average 30-day LIBOR rate decreased to 0.28% for the three months ended December 31, 2009 as compared to 2.89% for the corresponding period ended December 31, 2008. The decrease driven by the reduction in 30-day LIBOR rates was offset in part by the increase in average indebtedness and impacted by notional amounts of interest rate swap agreements, which convert a substantial portion of the Company s floating rate debt to fixed rate debt. The weighted average notional amount of interest rate swaps was $57.4 million at a weighted average fixed rate of 3.91% for the three months ended December 31, 2009 as compared to $80.0 million at 4.01% for the corresponding period ended December 31, 2008. For further discussions regarding the Company s cost of funds and the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements . The average cost of borrowings in future periods will continue to be impacted by such factors as well as pricing options under the new credit agreement entered into on January 12, 2010. For further discussions regarding the new credit agreement and the increase of amounts available under the Line see note 9 Subsequent Events .

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Nine months ended December 31, 2009 compared to nine months ended December 31, 2008

Interest Income and Loan Portfolio

Interest income and fee on finance receivables, predominately finance charge income, increased 6% to approximately $42.2 million for the nine-month period ended December 31, 2009 from $39.8 million for the corresponding period ended December 31, 2008. Average finance receivables, net of unearned interest equaled approximately $221.6 million for the nine-month period ended December 31, 2009, an increase of 7% from $206.8 million for the corresponding period ended December 31, 2008. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and the opening of two additional branch locations. The gross finance receivable balance increased 9% to approximately $316.3 million as of December 31, 2009, from $291.5 million as of December 31, 2008. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 25.68% for the nine-month period ended December 31, 2008 to 25.37% for the nine-month period ended December 31, 2009. The net portfolio yield increased from 14.57% for the nine-month period ended December 31, 2008 to 17.41% for the corresponding period ended December 31, 2009. The gross portfolio yield decreased primarily due to a lower weighted annual percentage rate (APR) earned on finance receivables. The net portfolio yield increased primarily due to a decrease in the average cost of borrowed funds and a reduction in the provision for credit losses.

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

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $17.4 million for the nine-month period ended December 31, 2009 from approximately $16.8 million for the corresponding period ended December 31, 2008. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.38% for the nine-month period ended December 31, 2009 from 10.67% for the nine-month period ended December 31, 2008. The Company has implemented certain cost control measures which have reduced operating expenses during the nine-month period ended December 31, 2009.

Interest Expense

Interest expense decreased to approximately $3.6 million for the nine-month period ended December 31, 2009 from $4.1 million for the nine-month period ended December 31, 2008. The average indebtedness for the nine-month period ended December 31, 2009 increased to approximately $106.5 million as compared to $103.7 million for the corresponding period ended December 31, 2008. The Company s average cost of borrowed funds decreased to 4.57% for the nine-month period ended December 31, 2009 as compared to 5.28% for the corresponding period ended December 31, 2008. The weighted-average 30-day LIBOR rate decreased to 0.35% for the nine months ended December 31, 2009 as compared to 2.67% for the corresponding period ended December 31, 2008. The decrease driven by the reduction in 30-day LIBOR rates was offset in part by the increase in average indebtedness and impacted by notional amounts of interest rate swap agreements, which convert a substantial portion of the Company s floating rate debt to fixed rate debt. The weighted average notional amount of interest rate swaps was $72.5 million at a weighted average fixed rate of 3.98% for the nine months ended December 31, 2009 as compared to $74.8 million at 4.03% for the corresponding period ended December 31, 2008. For further discussions regarding the Company s cost of funds and the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements . The average cost of borrowings in future periods will continue to be impacted by such factors as well as pricing options under the new credit agreement entered into on January 12, 2010. For further discussions regarding the new credit agreement and the increase of amounts available under the Line see note 9 Subsequent Events .

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Contract Procurement

The Company purchases Contracts in the twelve states listed in the table below. The Contracts purchased by the Company are predominately for used vehicles; for the three-month and nine-month periods ended December 31, 2009 and 2008, less than 3% were for new vehicles. As of December 31, 2009, the average model year of vehicles collateralizing the portfolio was a 2004 vehicle.

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

	Three months ended December 31,		Nine months ended December 31,	
State	**2009**	**2008**	**2009**	**2008**
FL	$ 9,532,921	$ 8,232,199	$ 33,171,711	$ 31,900,120
GA	3,190,248	2,323,341	9,277,157	8,245,818
NC	2,554,986	1,833,047	8,951,415	8,164,930
SC	375,972	383,500	1,679,072	1,672,662
OH	4,324,446	3,326,428	13,416,153	11,699,003
MI	819,325	746,055	2,709,104	2,100,454
VA	674,073	787,132	2,427,836	3,591,065
IN	1,434,669	1,598,370	4,762,365	5,163,710
KY	1,842,929	1,307,285	6,001,275	4,534,183
MD	156,294	158,808	728,913	1,512,474
AL	917,992	759,085	2,880,657	2,649,310
TN	403,594	270,181	1,574,038	1,478,971
Total	$ 26,227,449	$ 21,725,431	$ 87,579,696	$ 82,712,700

	Three months ended December 31,		Nine months ended December 31,	
Contracts	**2009**	**2008**	**2009**	**2008**
Purchases	$ 26,227,449	$ 21,725,431	$ 87,579,696	$ 82,712,700
Weighted APR	23.27%	23.73%	23.50%	24.05%
Average discount	9.08%	9.23%	9.07%	9.03%
Weighted average term (months)	48	49	48	48
Average loan	$ 9,486	$ 9,377	$ 9,465	$ 9,455
Number of Contracts	2,765	2,317	9,253	8,748

Loan Origination

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

	Three months ended December 31,		Nine months ended December 31,	
Direct Loans Originated	**2009**	**2008**	**2009**	**2008**
Originations	$ 1,007,170	$ 1,112,116	$ 3,018,240	$ 3,487,067

Weighted APR	26.83%	27.30%	26.69%	27.15%
Weighted average term (months)	23	23	23	24
Average loan	$ 2,630	$ 2,371	$ 2,629	$ 2,531
Number of loans	383	469	1,148	1,378

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Analysis of Credit Losses

As of December 31, 2009, the Company had 1,036 active static pools. The average pool upon inception consisted of 61 Contracts with aggregate finance receivables, net of unearned interest, of approximately $571,000.

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

	Three months ended December 31,		Nine months ended December 31,	
	2009	2008	2009	2008
Balance at beginning of period	$ 28,060,990	$ 23,183,977	$ 24,926,076	$ 20,112,260
Discounts acquired on new volume	2,380,471	1,980,990	7,939,936	7,359,920
Current period provision	2,921,300	4,390,700	9,463,038	12,485,249
Losses absorbed	(5,249,383)	(6,193,349)	(14,874,430)	(16,981,767)
Recoveries	506,933	452,373	1,416,590	1,326,309
Discounts accreted	(52,321)	(166,670)	(303,220)	(653,950)
Balance at end of period	$ 28,567,990	$ 23,648,021	$ 28,567,990	$ 23,648,021

The following table sets forth a reconciliation of the changes in the allowance for credit losses on direct loans.

	Three months ended December 31,		Nine months ended December 31,	
	2009	2008	2009	2008
Balance at beginning of period	$ 405,000	$ 483,174	$ 513,067	$ 335,057
Current period provision	98,286	176,939	133,463	629,795
Losses absorbed	(74,826)	(121,906)	(245,355)	(454,881)
Recoveries	16,175	12,911	43,460	41,147
Balance at end of period	$ 444,635	$ 551,118	$ 444,635	$ 551,118

The Company has seen evidence that the changes made to underwriting guidelines approximately one year ago have resulted in a positive effect on the static pools originated during that same timeframe. During comparable liquidation cycles, the default rate for static pools originated during the last year has decreased when compared to the preceding year s performance. However, from a historical perspective, charge-off rates remain high and the Company believes that continued weakness in employment will make it difficult for additional improvement. As a result, the Company experienced a lower net charge-off percentage of 8.39% during the three-month period ended December 31, 2009 as compared to 11.15% for the three-month period ended December 31, 2008. The Company experienced a lower net charge-off percentage of 8.12% during the nine-month period ended December 31, 2009 as compared to 10.27% for the nine-month period ended December 31, 2008. While the Company is encouraged with the decline in net charge-offs for these periods, it remains concerned over elevated delinquency levels, leading to an increase in the overall allowance for credit losses as a percentage of finance receivables.

The average dealer discount associated with new volume for the three months ended December 31, 2009 and 2008 were 9.08% and 9.23%, respectively. The average dealer discount associated with new volume for the nine months ended December 31, 2009 and 2008 were 9.07% and 9.03%, respectively. The amount of discount is a result of credit quality associated with contracts purchased and the competition in the markets in which the Company operates. The Company intends to remain focused on maintaining these discount levels to help off-set above average loss rates.

With the decrease in the net charge off percentage noted above, the provision for credit losses decreased from approximately $4.6 million for the three-month period ended December 31, 2008, to $3.0 million for the three-month period ended December 31, 2009. The provision for credit losses decreased from approximately $13.1 million for the nine-month period ended December 31, 2008, to $9.6 million for the nine-month period ended December 31, 2009. The Company s losses absorbed as a percentage of liquidation decreased from 14.62% for the three months ended December 31, 2008, to 11.27% for the three months ended December 31, 2009. The Company s losses absorbed as a percentage of liquidation decreased from 12.90% for the nine months ended December 31, 2008, to 11.07% for the nine months ended December 31, 2009. In addition, excess provisions reversed, increased from $68,000 for the three-month period ended December 31, 2008 to approximately $214,000 for the three-month period ended December 31, 2009. Excess provisions reversed increased from $78,000 for the nine-month period ended December 31, 2008 to approximately $467,000 for the nine-month period ended December 31, 2009. The reversal of provisions previously recorded in each period was due to the favorable charge-off performance of static pools originated from April 2005 through June 2006.

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The Company anticipates losses absorbed as a percentage of liquidation will be in the 9%-11% range during the remainder of the current fiscal year; however, no assurances can be given that the actual losses absorbed may not be higher as a result of further economic weakness. Effective October 1, 2008, the Company modified its Contract procurement underwriting guidelines. The primary changes include: raising the minimum income required by the debtor to qualify for loan approval, reducing the maximum dollar amount that can be advanced for certain loan applications, and the maximum dollar amount that can be approved by a branch manager on certain approvals. The longer-term outlook for portfolio performance will depend on the overall economic conditions, the unemployment rate, the economic impact of any government sponsored stimulus package, and the price of oil which impacts the cost of gasoline, food and many other items used or consumed by the average person. Also, the Company s ability to monitor, manage and implement its underwriting philosophy in additional geographic areas as it strives to continue its expansion will impact future portfolio performance. The Company does not believe there have been any significant changes in loan concentrations or terms of Contracts purchased during the three and nine months ended December 31, 2009; however, the changes made to underwriting guidelines approximately one year ago have resulted in a positive effect on the static pools originated during that same timeframe.

Recoveries as a percentage of charge-offs increased from approximately 8% for the three months ended December 31, 2008 to approximately 11% for the three months ended December 31, 2009. Recoveries as a percentage of charge-offs increased from approximately 9% for the nine months ended December 31, 2008 to approximately 11% for the nine months ended December 31, 2009. Historically, recoveries as a percentage of charge-off s fluctuate from period to period and the Company does not attribute this increase to any particular change in operational strategy or economic event.

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

		Delinquencies			
Contracts	**Gross Balance Outstanding**	**30 59 days**	**60 89 days**	**90 + days**	**Total**
December 31, 2009	**$ 310,682,358**	**$ 11,437,840**	**$ 3,810,954**	**$ 1,819,393**	**$ 17,068,187**
		3.68%	**1.23%**	**0.59%**	**5.50%**
December 31, 2008	$ 283,571,200	$ 12,454,035	$ 5,022,847	$ 1,777,122	$ 19,254,004
		4.39%	1.78%	0.62%	6.79%

Direct Loans	**Gross Balance Outstanding**	**30 59 days**	**60 89 days**	**90 + days**	**Total**
December 31, 2009	**$ 5,599,857**	**$ 141,300**	**$ 83,097**	**$ 44,320**	**$ 268,717**
		2.52%	**1.48%**	**0.79%**	**4.79%**
December 31, 2008	$ 7,894,781	$ 234,606	$ 124,840	$ 97,807	$ 457,253
		2.97%	1.58%	1.24%	5.79%

The delinquency percentage for Contracts more than thirty days past due as of December 31, 2009 was 5.50% as compared to 6.79% as of December 31, 2008. The delinquency percentage for direct loans more than thirty days past due as of December 31, 2009 was 4.79% as compared to 5.79% as of December 31, 2008.

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

Income Taxes

Driven by increases in operating income, the provision for income taxes increased to approximately $1.8 million for the three months ended December 31, 2009 as compared to approximately $144,000 for the three months ended December 31, 2008. The provision for income taxes increased to approximately $4.7 million for the nine months ended December 31, 2009 as compared to approximately $1.6 million for the nine months ended December 31, 2008. The Company s effective tax rate increased from 38.08% for the three months ended December 31, 2008 to 38.66% for the three months ended December 31, 2009. The Company s effective tax rate increased from 38.09% for the nine months ended December 31, 2008 to 38.41% for the nine months ended December 31, 2009. The primary reason for increases in the effective tax rate was the result of a portion of the Company s taxable income reaching the 35% maximum Federal tax rate.

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Liquidity and Capital Resources

The Company s cash flows are summarized as follows:

	Nine months ended December 31,	
	2009	**2008**
Cash provided by (used in):		
Operating activities	$ 15,172,766	$ 16,294,883
Investing activities (primarily purchase of Contracts)	(20,871,528)	(18,095,233)
Financing activities	8,734,873	1,398,035
Net increase (decrease) in cash	$ 3,036,111	$ (402,315)

The Company s primary use of working capital for the nine months ended December 31, 2009 was the funding of the purchase of Contracts. The Company s Line is secured by all of the assets of the Company s Nicholas Financial, Inc. subsidiary. As of December 31, 2009 the Company could borrow the lesser of $115.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options plus 162.5 basis points or at the prime rate. Prime rate based borrowings are generally less than $5.0 million. As of December 31, 2009, the amount outstanding under the Line was approximately $110.4 million and the amount available under the Line was approximately $4.6 million.

Amounts outstanding under the Line have increased by $8.3 million during the nine months ended December 31, 2009. The growth of the Line is principally related to funding the purchase of Contracts and is consistent with the growth of finance receivables.

On January 12, 2010, the Company executed a new agreement with its consortium of lenders that increases the size of the Line from $115.0 million to $140.0 million. The contract extends the maturity date to November 30, 2011 and includes Wells Fargo Preferred Capital as a new participant in the Company s consortium of lenders. This amendment was effective January 12, 2010. The pricing of the new agreement is 300 basis points above 30-day Libor with a 1% floor on Libor. The Company will continue to depend on the availability of the Line, together with cash from operations, to finance future operations including the growth of existing branches and future branch openings (see Future Expansion below).

The Line requires compliance with certain debt covenants including financial ratios, asset quality and other performance tests. The Company is currently in compliance with all of its debt covenants but, during the current economic slowdown, a breach of one or more of these covenants could occur prior to November 30, 2011. The Company s consortium of lenders could place the Company in default if certain covenants were breached and take one or more of the following actions: increase the Company s borrowing costs; restrict the Company s ability to obtain additional borrowings under the Line; accelerate all amounts outstanding under the Line; or enforce its interests against collateral securing the Line. The Company believes its lenders will continue to allow it to operate in the event of a condition of default; however no assurance can be given that this would occur.

The Company has entered into interest rate swap agreements, each of which, in effect, convert a portion of the Company s floating-rate debt to a fixed-rate, thus reducing the impact of interest rate change on the Company s interest expense. As of December 31, 2009, approximately 45% of the Company s borrowings under the Line were subject to interest rate swap agreements as compared to 78% as of March 31, 2009. These swap agreements have maturities ranging from May 19, 2010 through February 2, 2011. Consistent with the Company s objective to minimize the cost of borrowing through an appropriate mix of fixed and floating rate debt, the Company is evaluating the extent to which it will enter additional interest rate swap agreements, if any, in managing fluctuating interest rate exposure under the new credit agreement.

On November 10, 2009 the Board of Directors declared a 10% stock dividend on December 7, 2009 to shareholders of record on November 20, 2009. As a result of this stock dividend, an entry of approximately $6.5 million was made to reflect the re-capitalization of shareholders equity from retained earnings to paid in capital. This amount was derived from using the quoted market value of the shares at the date of declaration ($6.10) times the number of shares issued as a result of the 10% stock dividend. All references in the condensed consolidated financial statements and notes to the number of shares outstanding, per share amounts, and share awards of the Company s common shares have been restated to reflect the effect of the stock dividend for all periods presented.

Future Expansion

The Company currently operates a total of fifty branch locations in twelve states, including nineteen in Florida, seven in Ohio, six in North Carolina, five in Georgia, three in Kentucky, two in Virginia, two in Indiana, two in Alabama and one in Michigan, Maryland, South Carolina, and Tennessee. Each office is budgeted (size of branch, number of employees and location) to handle up to 1,000 accounts and up to $7.5 million in outstanding finance receivables, net of unearned interest. To date, ten of our branches have reached this capacity. While the Company remains cautious, we are encouraged that the economy is showing some signs of stability and, subject to favorable market conditions, we will proceed with our planned expansion. We expect to open a second location in Tennessee, specifically in Antioch, during our fourth quarter ending March 31, 2010. We also plan on opening two additional branch locations during the first quarter of fiscal year 2011 which ends June 30, 2010. The Company continues to evaluate additional markets for future branch locations, and subject to market conditions, could open additional branch locations during the remaining quarters of fiscal 2011. The Company remains open to acquisitions should an opportunity present itself.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Interest rate risk

Management s objective is to minimize the cost of borrowing through an appropriate mix of fixed and floating rate debt. Derivative financial instruments, such as interest rate swap agreements, may be used for the purpose of managing fluctuating interest rate exposures that exist from ongoing business operations. During fiscal 2009, the Company undesignated all of its interest rate swaps as cash flow hedges. (See note 6 - Interest Rate Swap Agreements) The Company does not use interest rate swaps for speculative purposes. Such instruments continue to be intended for use as economic hedges.

ITEM 4. CONTROLS AND PROCEDURES

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

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

PART II - OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I Item 1A. Risk Factors in the Company s Annual Report on Form 10-K for the year ended March 31, 2009, which could materially affect our business, financial condition or future results. The risks described in the Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

(a) The Company s Annual General Meeting of Shareholders was held on August 11, 2009. The information set forth in this Item 4 was inadvertently omitted from the Company s Quarterly Report on Form 10-Q for the three months ended September 30, 2009.

(b) At the Company s Annual General Meeting of Shareholders, the following directors were reelected for terms expiring in 2012 by the votes indicated below:

	Shares Voted For	Shares Abstaining	Shares Withholding Authority
Scott Fink	8,417,579	17,863	
Alton R. Neal	8,378,263	95,499	

The directors whose terms of office as directors continued after the meeting were Peter L. Vosotas, Ralph T. Finkenbrink and Stephen Bragin.

(c) The only matter other than election of directors, brought for a vote at the Company s Annual General Meeting of Shareholders, passed by the following vote:

	Shares Voted For	Shares Abstaining	Shares Withholding Authority
Approval of Appointment of Dixon Hughes PLLC as the Company s independent auditors	8,014,355		420,555

ITEM 6. EXHIBITS

See exhibit index following the signature page.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

NICHOLAS FINANCIAL, INC.

(Registrant)

Date: February 16, 2010	/s/ Peter L. Vosotas Peter L. Vosotas Chairman of the Board, President, Chief Executive Officer and Director
Date: February 16, 2010	/s/ Ralph T. Finkenbrink Ralph T. Finkenbrink Senior Vice President, Chief Financial Officer and Director

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EXHIBIT INDEX

Exhibit No.	Description
10.1	Second Amended and Restated Loan and Security Agreement, dated January 12, 2010
10.9	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements
31.1	Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. § 1350
32.2	Certification of the Chief Financial Officer Pursuant to 18 U.S.C. § 1350