NICHOLAS FINANCIAL INC
Form 10QSB
February 14, 2005

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-QSB

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934 FOR THE PERIOD ENDED DECEMBER 31, 2004**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 (NO FEE REQUIRED)**

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 þ No o.

As of January 31st, 2005 there were 6,553,688 shares of common stock outstanding.

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PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc.

Condensed Consolidated Balance Sheet
(Unaudited)

	December 31, 2004
Assets	
Cash	$ 1,494,083
Finance receivables, net	106,988,799
Accounts receivable	10,716
Assets held for resale	705,146
Prepaid expenses and other assets	402,577
Property and equipment, net	645,749
Deferred income taxes	3,781,918
Total assets	$ 114,028,988
Liabilities	
Line of credit	$ 62,207,671
Drafts payable	552,304
Notes payable related party	1,000,000
Accounts payable	4,144,788
Dividends payable	324,914
Income taxes payable	595,895
Derivatives	62,281
Deferred revenues	1,331,940
Total liabilities	70,219,793
Shareholders equity	
Preferred stock, no par: 5,000,000 shares authorized; none issued and outstanding	
Common stock, no par: 50,000,000 shares authorized; 6,548,688 shares issued and outstanding	15,041,133
Accumulated other comprehensive loss	(38,605)
Retained earnings	28,806,667
	43,809,195
Total liabilities and shareholders equity	$ 114,028,988

See accompanying notes.

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Nicholas Financial, Inc.

Condensed Consolidated Statements of Income
(Unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	2004	2003	2004	2003
Revenue:				
Interest income on finance receivables	$ 8,484,354	$ 6,334,652	$ 23,495,609	$ 18,397,452
Sales	56,357	50,447	155,422	192,755
	8,540,711	6,385,099	23,651,031	18,590,207
Expenses:				
Cost of sales	17,043	10,456	45,904	39,145
Marketing	227,009	221,459	642,697	653,282
Administrative	3,203,333	2,437,986	9,079,230	7,235,719
Provision for credit losses	565,758	632,873	1,806,203	1,617,028
Depreciation	58,147	30,000	162,973	162,218
Interest	909,468	950,109	2,719,551	2,905,747
	4,980,758	4,282,883	14,456,558	12,613,139
Operating income before income taxes	3,559,953	2,102,216	9,194,473	5,977,068
Income tax expense:				
Current	1,640,355	1,060,332	4,532,854	3,356,708
Deferred	(294,049)	(264,155)	(1,050,092)	(1,100,546)
	1,346,306	796,177	3,482,762	2,256,162
Net Income	$ 2,213,647	$ 1,306,039	$ 5,711,711	$ 3,720,906
Earnings per share basic	$ 0.34	$ 0.26	$ 0.92	$ 0.74
Earnings per share diluted	$ 0.32	$ 0.24	$ 0.86	$ 0.69
Dividends declared per share			$ 0.10	$ 0.10

See accompanying notes.

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Nicholas Financial, Inc.

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended December 31, 2004	Nine months ended December 31, 2003
Operating activities		
Net income	$ 5,711,711	$ 3,720,906
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	162,973	162,218
Provision for credit losses	1,806,203	1,617,028
Deferred income taxes	(1,050,092)	(1,100,546)
Changes in operating assets and liabilities:		
Accounts receivable	1,207	(16,167)
Prepaid expenses, other assets and assets held for resale	(144,357)	(400,466)
Accounts payable and other liabilities	379,745	477,803
Income taxes payable	470,277	(201,379)
Deferred revenues	259,057	128,318
Net cash provided by operating activities	7,596,724	4,387,715
Investing activities		
Purchase and origination of finance contracts	(58,189,372)	(48,982,384)
Principal payments received	46,630,886	40,708,394
Purchase of property and equipment, net of disposals	(243,160)	(255,749)
Net cash used in investing activities	(11,801,646)	(8,529,739)
Financing activities		
Issuance of notes payable related party	318,470	172,920
Net (repayment) proceeds from line of credit	(5,302,619)	5,850,052
Payment of dividend	(324,915)	(253,354)
Decrease in drafts payable	(358,797)	(190,933)
Sale of common stock, net of offering costs	10,409,182	243,321
Net cash provided by financing activities	4,741,321	5,822,006
Net increase in cash	536,399	1,679,982
Cash, beginning of period	957,684	481,211
Cash, end of period	$ 1,494,083	$ 2,161,193

See accompanying notes.

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Nicholas Financial, Inc.

Notes to the Condensed Consolidated Financial Statements
(Unaudited)

December 31, 2004

1. Basis of Presentation

The accompanying unaudited 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-QSB pursuant to the Securities and Exchange Act of 1934, as amended in Article 10 of Regulation SB. 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. 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, 2005. For further information, refer to the condensed consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-KSB for the year ended March 31, 2004 as filed with the Securities Exchange Commission on June 29, 2004.

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 Company attributes all of the dealer discount and a portion of unearned income to a reserve for credit losses. Such amounts reduce the interest recognized over the life of the contract. 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 represents the amount of finance charges the Company expects to fully earn over the life of the current portfolio, and 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 all of its branch locations. After the analysis of purchase date accounting is complete, any uncollectable amounts would be contemplated in the allowance for credit losses.

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Nicholas Financial, Inc.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

3. Earnings Per Share

Basic earnings per share excludes any dilutive effects of common stock equivalents such as options, warrants, and convertible securities. Diluted earnings per share includes the effects of dilutive options, warrants, and convertible securities. Basic and diluted earnings per share have been computed as follows:

	Three months ended December 31,		Nine months ended December 31,	
	2004	**2003**	**2004**	**2003**
Numerator for earnings per share net income	$ 2,213,647	$ 1,306,039	$ 5,711,711	$ 3,720,906
Denominator:				
Denominator for basic earnings per share weighted average shares	6,514,634	5,064,623	6,227,129	5,036,730
Effect of dilutive securities:				
Employee stock options	415,285	374,366	402,601	359,085
Denominator for diluted earnings per share	6,929,919	5,438,989	6,629,730	5,395,815
Earnings per share basic	$ 0.34	$ 0.26	$ 0.92	$ 0.74
Earnings per share diluted	$ 0.32	$ 0.24	$ 0.86	$ 0.69

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Nicholas Financial, Inc.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

4. Finance Receivables

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

Finance receivables, gross Contracts	$ 171,166,964
Less: Unearned interest	(40,310,612)
Finance receivables, net of unearned interest	130,856,352
Less:	
Dealer discounts	(17,306,489)
Allowance for credit losses	(6,561,064)
Finance receivables, net	$ 106,988,799

The terms of the receivables range from 12 to 72 months and bear a weighted average effective interest rate of 24%.

5. Line of Credit

The Company has an $85.0 million Line of Credit facility (the Line) expiring on November 30, 2006. The Company may borrow the lesser of $85.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. For the three months ended December 31, 2004, $60.0 million of borrowings under the Line used LIBOR plus 212.5 basis points pricing options. The remainder of the borrowings under the Line used the prime rate plus 25 basis points pricing option. The prime rate based borrowings are generally less than $5.0 million. The Company s cost of borrowed funds based upon the interest rates charged under the line, related party debt and the effect of the swaps (see note 7) amounted to 5.69% and 5.70% for the three and nine months ended December 31, 2004, respectively, as compared to 5.73% and 6.03% for the three and nine month period ended December 31, 2003, 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, 2004, the amount outstanding under the Line was approximately $62.2 million and the amount available under the Line was approximately $22.8 million. As of December 31, 2004, the Company was in full compliance with all debt covenants thereunder.

6. Notes Payable - Related Party

The Company s notes payable consist of unsecured notes bearing interest at 5.92% with principal and interest due within 30-days upon demand. The notes totaled $1,000,000 at December 31, 2004, and are payable to a related party.

Nicholas Financial, Inc.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

7. Derivatives and Hedging

The Company is party to interest rate swap agreements classified as derivative instruments. 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.

The Company has entered into interest rate swap agreements that effectively convert a portion of its floating-rate debt to a fixed-rate basis, thus reducing the impact of interest rate changes on future interest expense. At December 31, 2004, $50.0 million of the Company s borrowings were designated as hedged items to interest rate swap agreements. Under the swap agreements, the Company received a weighted average variable rate of 2.06% and 1.14% for the three months ended December 31, 2004 and 2003, respectively. During the same period the Company paid a weighted average fixed rate of 3.59% and 4.22%, respectively. Under the swap agreements, the Company received a weighted average variable rate of 1.55% and 1.18% for the nine months ended December 31, 2004 and 2003, respectively. During the same period the Company paid a weighted average fixed rate of 3.75% and 4.22%, respectively. A liability of $62,281 related to the fair value of the swaps at December 31, 2004 has been recorded in the caption derivatives on the balance sheet. Accumulated other comprehensive loss at December 31, 2004, in the amount of $38,605 represents the after-tax effect of the derivative loss. Amounts of net income or losses on derivative instruments expected to be reclassified from comprehensive income to earnings in the next 12 months are not expected to be material.

The Company has entered into the following cash-flow hedges:

Date Entered	Effective Date	Notional Amount	Fixed Rate Of Interest	Maturity Date
June 28, 2002	June 28, 2002	$ 10,000,000	3.83%	July 2, 2005
January 6, 2003	April 2, 2003	$ 10,000,000	3.35%	April 2, 2007
January 31, 2003	August 1, 2003	$ 10,000,000	3.20%	August 2, 2006
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

The Company utilizes the above noted interest rate swaps to manage its 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. There has historically been no ineffectiveness associated with the Company s hedges.

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Notes to the Condensed Consolidated Financial Statements
(Unaudited)

7. Derivatives and Hedging (continued)

The following table reconciles net income with comprehensive income.

	Three months ended December 31,		Nine months ended December 31,	
	2004	**2003**	**2004**	**2003**
Net income	$ 2,213,647	$ 1,306,039	$ 5,711,711	$ 3,720,906
Mark to market interest rate swaps (net of tax)	263,808	361,673	1,026,737	561,300
Comprehensive income	$ 2,477,455	$ 1,667,712	$ 6,738,448	$ 4,282,206

8. Stock Options

The Company has an employee stock incentive plans (the SIP) for officers, directors and key employees. The Company is authorized to grant options for up to 940,000 common shares under the SIP, of which 211,633 shares were remaining available for future grants as of December 31, 2004. Of the 211,633 shares remaining available for future grants 173,333 shares are available for directors and 38,300 shares are available for employees. Options currently granted by the Company generally vest over a five-year period.

As permitted under Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation - Transaction and Disclosure , which amended SFAS 123, Accounting for Stock-Based Compensation , the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation arrangements as defined by Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees , and related interpretations including FASB Interpretation No. 44, Accounting for Certain Transactions Involving Stock Compensation , an interpretation of APB. 25. No stock-based employee compensation cost is reflected in operations, as all options granted under those plans have an exercise price equal to or above the market value of the underlying common stock on the date of grant.

The fair value method uses the Black-Scholes option-pricing model to determine compensation expense associated with the Company s options. The following table illustrates the effect on net income and net income per share if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee compensation:

	Three months ended December 31,		Nine months ended December 31,	
	2004	**2003**	**2004**	**2003**
Net income	$ 2,213,647	$ 1,306,039	$ 5,711,711	$ 3,720,906
Basic earnings per share	$ 0.34	$ 0.26	$ 0.92	$ 0.74
Fully diluted earnings per share	$ 0.32	$ 0.24	$ 0.86	$ 0.69
	$ 11,759	$ 10,509	$ 35,149	$ 32,535

Stock based employee compensation cost under the fair value method				
Pro forma net income	$ 2,201,888	$ 1,295,530	$ 5,676,562	$ 3,688,371
Pro forma basic earnings per share	$ 0.34	$ 0.26	$ 0.91	$ 0.73
Pro forma fully diluted earnings per share	$ 0.32	$ 0.24	$ 0.86	$ 0.68

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Nicholas Financial, Inc.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

9. Dividends

On August 17, 2004, the Company announced the Board of Directors had approved the payment of an annual cash dividend of $0.10 per share, payable semi-annually. The first cash dividend of $0.05 per share was paid on September 17, 2004, to shareholders of record as of August 27, 2004. The second cash dividend of $0.05 per share will be payable as determined by the Board of Directors.

10. Contingencies

For discussion of certain legal proceedings to which the Company is a party, see Item 3 in the Company s Annual Report on Form 10-KSB for the fiscal year ended March 31, 2004, as filed with the Securities and Exchange Commission on June 29, 2004.

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

Forward-Looking Information

This Form 10-QSB 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.

Introduction

Consolidated net income increased for the three months ended December 31, 2004, to $2,213,647 from $1,306,039 for the three months ended December 31, 2003. Consolidated net income increased for the nine months ended December 31, 2004, to $5,711,711 from $3,720,906 for the nine months ended December 31, 2003. Earnings were favorably impacted by an increase in the outstanding loan portfolio, a reduction in the average cost of borrowed funds and a reduction in the charge-off rate. The Company s Nicholas Data Services (NDS) subsidiary did not contribute significantly to consolidated operations in the three or nine month periods ended December 31, 2004 or 2003.

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Portfolio Summary

	Three months ended December 31,		Nine months ended December 31,	
	2004	2003	2004	2003
Average finance receivables, net of unearned interest (1)	$ 130,157,442	$ 112,338,303	$ 127,149,953	$ 110,248,781
Average indebtedness (2)	$ 63,908,352	$ 66,328,452	$ 63,564,709	$ 64,243,278
Finance revenue (3)	$ 8,484,354	$ 6,334,652	$ 23,495,609	$ 18,397,452
Interest expense	909,468	950,109	2,719,551	2,905,747
Net finance revenue	$ 7,574,886	$ 5,384,543	$ 20,776,058	$ 15,491,705
Weighted average contractual rate (4)	23.80%	23.85%	24.03%	24.02%
Average cost of borrowed funds (2)	5.69%	5.73%	5.70%	6.03%
Gross portfolio yield (5)	26.07%	22.56%	24.63%	22.25%
Interest expense as a percentage of average finance receivables, net of unearned interest	2.79%	3.38%	2.85%	3.51%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	1.74%	2.25%	1.89%	1.96%
Net portfolio yield (5)	21.54%	16.93%	19.89%	16.78%
Operating expenses as a percentage of average finance receivables, net of unearned interest (6)	10.54%	9.39%	10.18%	9.51%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	11.00%	7.54%	9.71%	7.27%

Write-off to liquidation (8)	7.45%	9.64%	6.99%	9.12%
Net charge-off percentage (9)	6.52%	8.11%	6.03%	7.79%

See accompanying notes to portfolio summary.

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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 during 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 page 14 and 15 for detail 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 page 14 and 15 for detail 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.

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Three months ended December 31, 2004 compared to three months ended December 31, 2003

Interest Income and Loan Portfolio

Finance revenue increased 34% to $8.5 million for the three months ended December 31, 2004, from $6.3 million for the corresponding period ended December 31, 2003. The average finance receivables, net of unearned interest balance equaled $130.2 million for the three months ended December 31, 2004, an increase of 16% from the $112.3 million for the three months ended December 31, 2003. The primary reason average finance receivables, net of unearned interest increased was the increase in the receivable base of several existing branches and having six additional branch locations open as of December 31, 2004. The gross finance receivable balance increased 16% to $171.2 million at December 31, 2004, from $147.6 million at December 31, 2003. The primary reason interest revenue increased was the increase in the outstanding loan portfolio. The gross portfolio yield increased from 22.56% for the three months ended December 31, 2003, to 26.07% for the corresponding period ended December 31, 2004. The net portfolio yield increased from 16.93% for the three months ended December 31, 2003, to 21.54% for the three months ended December 31, 2004. The primary reasons for the increase in the net portfolio yield were a decrease in charge-offs and a reduction in the cost of borrowed funds for the period ended December 31, 2004. The net charge-off percentage for the three-month period ended December 31, 2004, was 6.52% as compared to 8.11% for the corresponding period ended December 31, 2003.

Computer Software Business

Sales for the three months ended December 31, 2004, were $56,357 as compared to $50,447 for the corresponding period ended December 31, 2003, an increase of 12%. This increase was primarily due to higher revenue from the existing customer base during the three months ended December 31, 2004. Cost of sales and operating expenses increased from $65,754 for the three months ended December 31, 2003, to $77,229 for the corresponding period ended December 31, 2004.

Operating Expenses

Operating expenses, excluding provision for credit losses and interest expense and costs associated with NDS, increased to $3.4 million for the three months ended December 31, 2004, from $2.6 million for the corresponding period ended December 31, 2003. This increase of 30% was primarily attributable to the additional staffing of several existing branches, increased general operating expenses and having six additional branch offices. Operating expenses as a percentage of average finance receivables, net of unearned interest increased from 9.39% for the three months ended December 31, 2003, to 10.54% for the corresponding period ended December 31, 2004.

Interest Expense

Interest expense decreased to $909,468 for the three months ended December 31, 2004, as compared to $950,109 for the corresponding period ended December 31, 2003. The average indebtedness for the three months ended December 31, 2004, decreased to $63.9 million compared to $66.3 million for the corresponding period ended December 31, 2003. The primary reason for the decrease in average indebtedness was the completion of secondary common stock offering during May of 2004 netting the Company approximately $9.9 million. The average cost of outstanding borrowings decreased from 5.73% during the three months ended December 31, 2003, to 5.69% during the three months ended December 31, 2004.

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Nine months ended December 31, 2004 compared to nine months ended December 31, 2003

Interest Income and Loan Portfolio

Finance revenue increased 28% to $23.5 million for the nine months ended December 31, 2004, from $18.4 million for the corresponding period ended December 31, 2003. The average finance receivables, net of unearned interest balance equaled $127.1 million for the nine months ended December 31, 2004, an increase of 15% from the $110.2 million for the nine months ended December 31, 2003. The primary reason net finance receivables increased was the increase in the receivable base of several existing branches and having six additional branch locations as of December 31, 2004. The gross finance receivable balance increased 16% to $171.2 million at December 31, 2004, from $147.6 million at December 31, 2003. The primary reason interest revenue increased was the increase in the outstanding loan portfolio. The gross portfolio yield increased from 24.63% for the nine months ended December 31, 2003, to 22.25% for the corresponding period ended December 31, 2004. The net portfolio yield increased from 16.78% for the nine months ended December 31, 2003 to 19.89% for the nine months ended December 31, 2004. The primary reasons for the increase in the net portfolio yield were a decrease in charge-offs and a reduction in the cost of borrowed funds for the period ended December 31, 2004. The net charge-off percentage for the nine-month period ended December 31, 2004, was 6.03% as compared to 7.79% for the corresponding period ended December 31, 2003.

Computer Software Business

Sales for the nine months ended December 31, 2004, were $155,422 compared to $192,755 for the corresponding period ended December 31, 2003, a decrease of 19%. This decrease was primarily due to lower revenue from the existing customer base during the nine months ended December 31, 2004. Cost of sales and operating expenses decreased from $230,509 for the nine months ended December 31, 2003, to $221,310 for the corresponding period ended December 31, 2004.

Operating Expenses

Operating expenses, excluding provision for credit losses and interest expense and costs associated with NDS, increased to $9.7 million for the nine months ended December 31, 2004, from $7.9 million for the corresponding period ended December 31, 2003. This increase of 24% was primarily attributable to the additional staffing of several existing branches, increased general operating expenses and having six additional branch offices. Operating expenses as a percentage of average finance receivables, net of unearned interest assets decreased f