

NICHOLAS FINANCIAL INC

Form 10-Q

November 10, 2008

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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 SEPTEMBER 30, 2008

.. **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)

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British Columbia, Canada
(State or Other Jurisdiction of

8736-3354
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

2454 McMullen Booth Road, Building C

Clearwater, Florida
(Address of Principal Executive Offices)

33759
(Zip Code)

(727) 726-0763

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 and 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter periods that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company

Indicate by checkmark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act) Yes No

As of October 31, 2008, the registrant had 10,313,831 shares of common stock outstanding.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	September 30, 2008 (Unaudited)	March 31, 2008
Assets		
Cash	\$ 2,551,029	\$ 2,297,451
Finance receivables, net	186,134,678	179,043,344
Accounts receivable	5,392	4,201
Assets held for resale	1,520,319	1,130,183
Prepaid expenses and other assets	676,965	656,415
Property and equipment, net	869,127	844,086
Income taxes receivable		686,528
Deferred income taxes	5,609,146	5,175,617
 Total assets	 \$ 197,366,656	 \$ 189,837,825
Liabilities		
Line of credit	\$ 106,125,000	\$ 99,937,198
Drafts payable	888,974	1,433,223
Accounts payable and accrued expenses	4,896,608	5,803,695
Income taxes payable	590,880	
Deferred revenues	1,389,750	1,477,272
Derivatives	839,113	2,609,998
 Total liabilities	 114,730,325	 111,261,386
Shareholders' equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued or outstanding		
Common stock, no par: 50,000,000 shares authorized; 10,313,831 and 10,230,031 shares issued and outstanding, respectively	17,822,248	17,204,883
Accumulated other comprehensive loss	(517,900)	(1,610,891)
Retained earnings	65,331,983	62,982,447
 Total shareholders' equity	 82,636,331	 78,576,439
 Total liabilities and shareholders' equity	 \$ 197,366,656	 \$ 189,837,825

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)

	Three months ended September 30,		Six months ended September 30,	
	2008	2007	2008	2007
Revenue:				
Interest and fee income on finance receivables	\$ 13,487,161	\$ 12,559,769	\$ 26,591,127	\$ 24,708,258
Sales	18,196	17,942	33,294	40,006
	13,505,357	12,577,711	26,624,421	24,748,264
Expenses:				
Cost of sales	5,203	4,881	9,431	12,906
Marketing	338,803	319,881	675,438	633,727
Salaries and employee benefits	3,384,852	3,201,831	6,834,655	6,240,378
Administrative	1,771,533	1,527,718	3,741,675	2,985,353
Provision for credit losses	5,144,950	1,590,797	8,547,404	2,766,386
Depreciation	91,232	87,943	179,504	177,225
Interest expense	1,431,677	1,643,262	2,841,013	3,231,870
	12,168,250	8,376,313	22,829,120	16,047,845
Operating income before income taxes	1,337,107	4,201,398	3,795,301	8,700,419
Income tax expense	545,264	1,604,782	1,445,765	3,319,913
Net income	\$ 791,843	\$ 2,596,616	\$ 2,349,536	\$ 5,380,506
Earnings per share:				
Basic	\$ 0.08	\$ 0.26	\$ 0.23	\$ 0.54
Diluted	\$ 0.08	\$ 0.25	\$ 0.23	\$ 0.52

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six months ended September 30,	
	2008	2007
Cash flows from operating activities		
Net income	\$ 2,349,536	\$ 5,380,506
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	179,504	177,225
Gain on sale of property and equipment	(16,764)	(19,956)
Provision for credit losses	8,547,404	2,766,386
Deferred income taxes	(1,111,424)	177,053
Share-based compensation	339,358	224,269
Changes in operating assets and liabilities:		
Accounts receivable	(1,191)	8,563
Prepaid expenses and other assets	(20,550)	(396,849)
Accounts payable and accrued expenses	(907,087)	164,020
Income taxes payable and receivable	1,277,408	(225,648)
Deferred revenues	(87,522)	52,456
Net cash provided by operating activities	10,548,672	8,308,025
Cash flows from investing activities		
Purchase and origination of finance contracts	(56,014,917)	(55,032,593)
Principal payments received	40,376,179	44,319,991
Increase in assets held for resale	(390,136)	(362,669)
Purchase of property and equipment	(213,536)	(87,935)
Proceeds from sale of property and equipment	25,755	20,563
Net cash used in investing activities	(16,216,655)	(11,142,643)
Cash flows from financing activities		
Net proceeds from line of credit	6,187,802	3,540,111
(Decrease) increase in drafts payable	(544,249)	54,612
Proceeds from exercise of stock options	98,056	63,703
Net excess tax benefits related to exercise of stock options and issuance of performance share awards	179,952	128,303
Net cash provided by financing activities	5,921,561	3,786,729
Net increase in cash	253,578	952,111
Cash, beginning of period	2,297,451	1,499,193
Cash, end of period	\$ 2,551,029	\$ 2,451,304

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, 2008, 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, 2009. 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, 2008 as filed with the Securities and Exchange Commission on June 16, 2008. The March 31, 2008 condensed consolidated balance sheet included herein has been derived from the March 31, 2008 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 derivative instruments.

Certain prior period amounts have been reclassified to conform to current financial statement presentation with no effect on net income or shareholders' equity.

2. Revenue Recognition

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

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

A dealer discount represents the difference between the finance receivable, net of unearned interest, of a Contract and the amount of money the Company actually pays for the Contract. The entire amount of discount is related to credit quality and is considered to be part of the credit loss reserve. The Company receives a commission for selling add-on services to consumer borrowers and amortizes the commission, net of the related costs, over the term of the loan using the effective 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 effective interest method.

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

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Notes to the Condensed Consolidated Financial Statements

(Unaudited)

3. Earnings Per Share

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

	Three months ended September 30,		Six months ended September 30,	
	2008	2007	2008	2007
Numerator for earnings per share net income	\$ 791,843	\$ 2,596,616	\$ 2,349,536	\$ 5,380,506
Denominator:				
Denominator for basic earnings per share weighted average shares	10,244,831	10,035,998	10,216,264	10,020,085
Effect of dilutive securities:				
Stock options and other share awards	181,320	290,070	193,174	329,141
Denominator for diluted earnings per share	10,426,151	10,326,068	10,409,438	10,349,226
Earnings per share basic	\$ 0.08	\$ 0.26	\$ 0.23	\$ 0.54
Earnings per share diluted	\$ 0.08	\$ 0.25	\$ 0.23	\$ 0.52

For the three and six months ended September 30, 2008 potential common stock from approximately 134,500 and 324,500 stock options, respectively, were not included in the diluted earnings per share calculation because their effect is antidilutive.

4. Finance Receivables

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

	September 30, 2008	March 31, 2008
Finance receivables, gross contract	\$ 295,744,879	\$ 280,215,512
Unearned interest	(85,943,050)	(80,724,851)
Finance receivables, net of unearned interest	209,801,829	199,490,661
Allowance for credit losses	(23,667,151)	(20,447,317)
Finance receivables, net	\$ 186,134,678	\$ 179,043,344

The terms of the receivables range from 12 to 72 months and bear a weighted average interest rate of approximately 24% as of September 30, 2008.

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 5.45% and 5.49% for the three and six months ended September 30, 2008, respectively, as compared to 6.87% and 6.82% for the three and six month period ended September 30, 2007, respectively. Pledged as collateral for this credit facility are all of the assets of the Company. As of September 30, 2008 the outstanding amount of the credit facility was approximately \$106.1 million and the amount available under the line of credit was approximately \$8.9 million. The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends require consent in writing by the agent and majority lenders under the facility. As of September 30, 2008, the Company was in full compliance with all debt covenants.

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(Unaudited)

6. Derivatives and Hedging

The Company utilizes interest rate swap agreements to manage interest rate exposure. The swap agreements 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. As of September 30, 2008, \$80,000,000 of the Company's borrowings have been designated as the hedged items to interest rate swap agreements which are detailed as follows:

Date Entered	Effective Date	Notional Amount	Fixed Rate Of Interest	Maturity Date
March 11, 2004	October 5, 2004	\$ 10,000,000	3.64%	October 2, 2009
January 18, 2005				