NICHOLAS FINANCIAL INC
Form 10-Q
February 09, 2009
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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, 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)

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

(727) 726-0763

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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, 2009, the registrant had 10,373,831 shares of common stock outstanding.

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NICHOLAS FINANCIAL, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	December 31, 2008 (Unaudited)	March 31, 2008
Assets		
Cash	$ 1,895,136	$ 2,297,451
Finance receivables, net	183,502,141	179,043,344
Assets held for resale	1,419,786	1,130,183
Prepaid expenses and other assets	585,926	660,616
Property and equipment, net	822,044	844,086
Income taxes receivable		686,528
Deferred income taxes	6,918,904	5,175,617
Total assets	$ 195,143,937	$ 189,837,825
Liabilities		
Line of credit	$ 101,530,022	$ 99,937,198
Drafts payable	853,143	1,433,223
Accounts payable and accrued expenses	5,222,733	5,803,695
Income taxes payable	350,638	
Deferred revenues	1,273,414	1,477,272
Interest rate swaps	3,181,458	2,609,998
Total liabilities	112,411,408	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; 10,373,831 and 10,230,031 shares issued and outstanding, respectively	18,102,080	17,204,883
Accumulated other comprehensive loss	(936,439)	(1,610,891)
Retained earnings	65,566,888	62,982,447
Total shareholders equity	82,732,529	78,576,439
Total liabilities and shareholders equity	$ 195,143,937	$ 189,837,825

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	2008	2007	2008	2007
Revenue:				
Interest and fee income on finance receivables	$ 13,239,373	$ 12,593,397	$ 39,830,500	$ 37,301,655
Sales	14,927	21,085	48,221	61,091
	13,254,300	12,614,482	39,878,721	37,362,746
Expenses:				
Cost of sales	3,060	13,715	12,491	26,621
Marketing	310,163	313,808	985,601	947,535
Salaries and employee benefits	3,303,807	3,056,564	10,138,462	9,296,942
Administrative	1,666,277	1,531,082	5,407,952	4,516,436
Provision for credit losses	4,567,640	2,446,564	13,115,044	5,212,949
Depreciation	91,090	87,274	270,594	264,499
Interest expense	1,268,669	1,610,758	4,109,682	4,842,628
Unrealized mark-to-market loss on interest rate swaps	1,664,220		1,664,220	
	12,874,926	9,059,765	35,704,046	25,107,610
Operating income before income taxes	379,374	3,554,717	4,174,675	12,255,136
Income tax expense	144,469	1,318,293	1,590,234	4,638,206
Net income	$ 234,905	$ 2,236,424	$ 2,584,441	$ 7,616,930
Earnings per share:				
Basic	$ 0.02	$ 0.22	$ 0.25	$ 0.76
Diluted	$ 0.02	$ 0.22	$ 0.25	$ 0.74

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended December 31,	
	2008	**2007**
Cash flows from operating activities		
Net income	$ 2,584,441	$ 7,616,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	270,594	264,499
Gain on sale of property and equipment	(16,763)	(33,689)
Provision for credit losses	13,115,044	5,212,949
Deferred income taxes	(2,161,595)	200,893
Share-based compensation	511,906	273,968
Unrealized mark-to-market loss on interest rate swaps	1,664,220	
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	74,690	(9,476)
Accounts payable and accrued expenses	(580,962)	(1,359,690)
Income taxes payable and receivable	1,037,166	(856,824)
Deferred revenues	(203,858)	(58,736)
Net cash provided by operating activities	16,294,883	11,250,824
Cash flows from investing activities		
Purchase and origination of finance contracts	(75,894,747)	(79,025,118)
Principal payments received	58,320,906	66,237,816
Increase in assets held for resale	(289,603)	(858,568)
Purchase of property and equipment	(257,544)	(135,833)
Proceeds from sale of property and equipment	25,755	41,098
Net cash used in investing activities	(18,095,233)	(13,740,605)
Cash flows from financing activities		
Net proceeds from line of credit	1,592,824	5,891,386
Decrease in drafts payable	(580,080)	(488,385)
Proceeds from exercise of stock options	193,056	110,352
Net excess tax benefits related to exercise of stock options and issuance of performance share awards	192,235	182,230
Net cash provided by financing activities	1,398,035	5,695,583
Net (decrease) increase in cash	(402,315)	3,205,802
Cash, beginning of period	2,297,451	1,499,193
Cash, end of period	$ 1,895,136	$ 4,704,995

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 interest rate swaps.

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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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

3. Earnings Per Share

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

	Three months ended December 31,		Nine months ended December 31,	
	2008	2007	2008	2007
Numerator for earnings per share net income	$ 234,905	$ 2,236,424	$ 2,584,441	$ 7,616,930
Denominator:				
Denominator for basic earnings per share weighted average shares	10,259,179	10,045,493	10,230,621	10,028,280
Effect of dilutive securities:				
Stock options and other share awards	118,682	252,622	137,860	317,274
Denominator for diluted earnings per share	10,377,861	10,298,115	10,368,481	10,345,554
Earnings per share basic	$ 0.02	$ 0.22	$ 0.25	$ 0.76
Earnings per share diluted	$ 0.02	$ 0.22	$ 0.25	$ 0.74

For the three and nine months ended December 31, 2008 potential common stock from approximately 437,500 and 367,000 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:

	December 31, 2008	March 31, 2008
Finance receivables, gross contract	$ 291,465,981	$ 280,215,512
Unearned interest	(83,764,701)	(80,724,851)
Finance receivables, net of unearned interest	207,701,280	199,490,661
Allowance for credit losses	(24,199,139)	(20,447,317)
Finance receivables, net	$ 183,502,141	$ 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 December 31, 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 4.87% and 5.28% for the three and nine months ended December 31, 2008, respectively, as compared to 6.51% and 6.71% for the three and nine month period ended December 31, 2007, respectively. Pledged as collateral for this credit facility are all of the assets of the Company. As of December 31, 2008 the outstanding amount of the credit facility was approximately $101.5 million and the amount available under the line of credit was approximately $13.5 million. The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends require consent in writing by the agent and majority lenders under the facility. As of December 31, 2008, the Company was in full compliance with all debt covenants.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

6. Interest Rate Swap Agreements

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. As of December 31, 2008, the Company has interest rate swaps comprising an aggregate notional amount of $80,000,000 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

The Company utilized interest rate swaps to protect against variability due to interest rate risk related to the Line discussed in note 5 Line of Credit . These interest rate swaps were previously designated as cash flow hedges in accordance with Statement of Financial Accounting Standards (SFAS) No. 133, Derivative Instruments and Hedging Activities , as amended. 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 rates 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 mark-to-market value of interest rate swaps (unrealized gains and losses) are recorded in earnings. Unrealized losses previously recorded in accumulated other comprehensive loss are now 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.

From October 6, 2008 to December 31, 2008 approximately $279,000 of unrealized losses were reclassified from accumulated other comprehensive loss to the unrealized mark-to-market loss on interest rate swaps line item of the consolidated statement of income.

At December 31, 2008 remaining accumulated other comprehensive loss, net of tax, was approximately $936,000. Prospective amounts expected to be reclassified and effect net earnings are as follows:

Year ending March 31:	2009	2010	2011
	$ 180,000	$ 578,000	$ 178,000

In addition, the change in the fair value of interest rate swaps from October 6, 2008 to December 31, 2008 of approximately $1,385,000 was recorded in the unrealized mark-to-market loss on 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. Under the swap agreements, the Company received an average variable rate of 2.89% and 5.02% for the three months ended December 31, 2008 and 2007, respectively. During the same periods the Company paid an average fixed rate of 4.01% and 4.24%, respectively. Under the swap agreements, the Company received an average variable rate of 2.67% and 5.23% for the nine months ended December 31, 2008 and 2007, respectively. During the same periods the Company paid an average fixed rate of 4.03% and 4.16%, respectively. The interest rate

swap liabilities are recorded at fair value, which is approximately $3,181,000 and $2,610,000 as of December 31, and March 31, 2008, respectively, in the interest rate swaps line item of the condensed consolidated balance sheet. Accumulated other comprehensive loss as of December 31, and March 31, 2008 of approximately $936,000 and $1,611,000, respectively, represents the after-tax effect of the derivative losses. As noted above, these unrealized losses previously recorded in accumulated other comprehensive loss while interest rate swaps were designated as cash flow hedges will be reclassified into earnings as interest payments on the Line affect earnings over the remaining term of the respective swap agreements.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

6. Interest Rate Swap Agreements (continued)

The following table reconciles net income with comprehensive income.

	Three months ended December 31,		Nine months ended December 31,	
	2008	2007	2008	2007
Net income	$ 234,905	$ 2,236,424	$ 2,584,441	$ 7,616,930
Mark-to-market of interest rate swaps, net of tax benefit (expense) of $366,572, $419,902, and ($311,323), $562,134, respectively through October 6, 2008	(591,036)	(678,520)	501,955	(909,102)
Reclassification adjustment for loss included in net income, net of tax expense of $106,986 after October 6, 2008	172,497		172,497	
Comprehensive income (loss)	$ (183,634)	$ 1,557,904	$ 3,258,893	$ 6,707,828

7. Recently Issued Accounting Standards

Effective April 1, 2008, the Company adopted SFAS No. 157, Fair Value Measurements and SFAS No. 159 The Fair Value Option for Financial Assets and Liabilities . SFAS No. 157 establishes a framework for using fair value. It defines fair value rules 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. SFAS No. 159 generally permits the measurement of selected eligible financial instruments at fair value at specified election dates. Upon adoption of SFAS No. 159, the Company did not elect to adopt the fair value option for any financial instruments.

SFAS No. 157 was effective for the Company on April 1, 2008; however, in February 2008 the FASB released FASB Staff Position No. FAS 157-2, Effective Date of FASB Statement No. 157 , which delayed the effective date of SFAS No. 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Accordingly, the Company adopted the provisions of SFAS No. 157 only with respect to financial assets and liabilities as of April 1, 2008. The adoption of SFAS No. 157 for financial assets and liabilities did not have a material impact on the consolidated financial statements. The Company is currently assessing the potential effect of adopting SFAS No. 157 on the consolidated financial statements for non-financial assets and liabilities, which will be adopted on April 1, 2009.

SFAS No. 157 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. The standard describes three levels of inputs that 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 exchange market, as well as certain U.S. Treasury, other U.S. Government and agency mortgage-backed debt securities that are highly liquid and are actively traded in over-the-counter markets.

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 debt securities with quoted prices that are traded less frequently than exchange-traded instruments and 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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Notes to the Condensed Consolidated Financial Statements

(Unaudited)

7. Recently Issued Accounting Standards (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.

Following is a description of valuation methodology currently used for assets and liabilities recorded at fair value.

Interest Rate Swap Agreements

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:

	December 31, 2008			
	Fair Value Measurement Using			Assets/ Liabilities Measured at
Description	Level 1	Level 2	Level 3	Fair Value
Interest rate swap agreements	$	$ 3,181,458	$	$ 3,181,458

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.

In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities . SFAS No. 161 requires companies with derivative instruments to disclose information that should enable financial-statement users to understand how and why a company uses derivative instruments, how derivative instruments and related hedged items are accounted for under SFAS No. 133, and how derivative instruments and related hedged items affect a company s financial position, financial performance and cash flows. The Company is currently evaluating SFAS No. 161 and the potential impact that adoption on April 1, 2009 will have on the consolidated financial statements.

In October, 2008, the FASB issued FASB Staff Position (FSP) FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active (FSP 157-3). FSP 157-3 clarifies the application of SFAS 157 and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. FSP 157-3 is effective upon issuance, including prior periods for which financial statements have not been issued. Revisions resulting from a change in the valuation technique or its application should be accounted for as a change in accounting estimate following the guidance in SFAS Statement No. 154,

Accounting Changes and Error Corrections or SFAS 154. However, the disclosure provisions in SFAS 154 for a change in accounting estimate are not required for revisions resulting from a change in valuation technique or its application. The Company has evaluated the new FSP and has determined that it will 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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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 discount and a provision for loss based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans and current economic conditions. Such evaluation, which includes a review of all loans on which full collectibility may not be reasonably assured, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management s estimate of probable credit losses and other factors that warrant recognition in providing for an adequate credit loss allowance.

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

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

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

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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 allowance for credit losses. The Company utilizes a static pool approach to track portfolio performance. A static pool retains an amount equal to 100% of the discount as a reserve for credit losses.

Subsequent to the purchase, if the reserve for credit losses is determined to be inadequate for a static pool, which is not fully liquidated, then an additional charge to income through the provision is used to reestablish adequate reserves. For static pools not fully liquidated that are deemed to have excess reserves, such amounts are then considered when calculating the provision for credit losses on specific pools. If a static pool is fully liquidated and has any remaining reserves, these excess reserves are immediately reversed during the period.

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

Introduction

Consolidated net income decreased to approximately $235,000 for the three-month period ended December 31, 2008 as compared to $2.2 million for the corresponding period ended December 31, 2007. Consolidated net income decreased to $2.6 million for the nine-month period ended December 31, 2008 as compared to $7.6 million for the corresponding period ended December 31, 2007. Net income for the three and nine months ended December 31, 2008 includes a pre-tax charge of $1.7 million related to the non-cash unrealized mark-to-market interest rate swap losses. Earnings were negatively impacted primarily by an increase in the provision for credit losses, which was driven by increased charge-off rates and to a lesser extent an increase in operating expenses as a percentage of average finance receivables, net of unearned interest. The Company s software subsidiary, Nicholas Data Services (NDS), did not contribute significantly to consolidated operations in the three or nine months ended December 31, 2008 or 2007, respectively.

As discussed in note 6 Interest Rate Swaps , 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 there 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 unrealized mark-to-market loss on 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, 2008, net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps, decreased 43% to $1.3 million compared to $2.2 million for the three months ended December 31, 2007. Per share diluted net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps, decreased 45% to $0.12 for the three months ended December 31, 2008 as compared to $0.22 for the three months ended December 31, 2007. See reconciliations of the non-GAAP measures on the following page.

For the nine months ended December 31, 2008, net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps, decreased 53% to $3.6 million as compared to $7.6 million for the nine months ended December 31, 2007. Per share diluted net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps, decreased 53% to $0.35 for the nine months ended December 31, 2008 as compared to $0.74 for the nine months ended December 31, 2007. 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 non-cash unrealized mark-to-market loss on interest rate swaps and per share diluted net earnings, excluding non-cash unrealized mark-to-market loss on 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 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 non-cash unrealized mark-to-market loss on interest rate swaps as well as GAAP reported diluted earnings per share to the non-GAAP measure, per share diluted net earnings, excluding non-cash unrealized mark-to-market loss on 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,	
	2008	2007	2008	2007
Net income, GAAP	$ 234,905	$ 2,236,424	$ 2,584,441	$ 7,616,930
Mark-to-market of interest rate swaps (net of tax of $632,316)	1,031,904		1,031,904	
Net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps **(a)**	$ 1,266,809	$ 2,236,424	$ 3,616,345	$ 7,616,930

	Three months ended December 31,		Nine months ended December 31,	
	2008	2007	2008	2007
Diluted earnings per share, GAAP	$ 0.02	$ 0.22	$ 0.25	$ 0.74
Per diluted share mark-to-market of interest rate swaps	$ 0.10		$ 0.10	
Per share diluted net earnings, excluding non-cash unrealized mark-to-market loss on interest rate swaps **(a)**	$ 0.12	$ 0.22	$ 0.35	$ 0.74

(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, 2008	Three months ended December 31, 2007	Nine months ended December 31, 2008	Nine months ended December 31, 2007
Average finance receivables, net of unearned interest (1)	$ 208,438,920	$ 192,408,861	$ 206,814,055	$ 189,618,834
Average indebtedness (2)	$ 104,109,909	$ 98,899,680	$ 103,705,519	$ 96,177,013
Finance revenue (3)	$ 13,239,373	$ 12,593,397	$ 39,830,500	$ 37,301,655
Interest expense	1,268,669	1,610,758	4,109,682	4,842,628
Net finance revenue	$ 11,970,704	$ 10,982,639	$ 35,720,818	$ 32,459,027
Weighted average contractual rate (4)	23.90%	24.14%	24.17%	24.25%
Average cost of borrowed funds (2)	4.87%	6.51%	5.28%	6.71%
Gross portfolio yield (5)	25.41%	26.18%	25.68%	26.23%
Interest expense as a percentage of average finance receivables, net of unearned interest	2.43%	3.35%	2.65%	3.41%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	8.77%	5.09%	8.46%	3.67%
Net portfolio yield (5)	14.21%	17.74%	14.57%	19.15%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	10.22%	10.27%	10.67%	10.46%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	3.99%	7.47%	3.90%	8.69%
Write-off to liquidation (8)	14.62%	10.35%	12.90%	8.77%
Net charge-off percentage (9)	11.15%	9.51%	10.27%	7.98%

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 is interest and fee income on finance receivables and does not include sales revenue generated by NDS.
(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 revenue 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 $48,000 during each of the three-month periods ended December 31, 2008 and 2007 and $259,000 and $150,000 during the nine-month periods ended December 31, 2008 and 2007, 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, 2008 compared to three months ended December 31, 2007

Interest Income and Loan Portfolio

Interest income on finance receivables, predominately finance charge income, increased 5% to approximately $13.2 million for the three-month period ended December 31, 2008, from $12.6 million for the corresponding period ended December 31, 2007. Average finance receivables, net of unearned interest equaled approximately $208.4 million for the three-month period ended December 31, 2008, an increase of 8% from $192.4 million for the corresponding period ended December 31, 2007. 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 during fiscal 2008 and the first six months of fiscal 2009. The gross finance receivable balance increased 9% to approximately $291.5 million as of December 31, 2008 from $267.3 million as of December 31, 2007. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 26.18% for the three-month period ended December 31, 2007 to 25.41% for the three-month period ended December 31, 2008. The net portfolio yield decreased from 17.74% for the three-month period ended December 31, 2007 to 14.21% for the corresponding period ended December 31, 2008. The gross portfolio yield decreased due to reduced accretion of discounts as compared to the prior year (see discussion under Analysis of Credit Losses below). The net portfolio yield decreased due to the above factor plus the effect of additional provision in response to increased charge-off rates.

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

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $5.4 million for the three-month period ended December 31, 2008 from approximately $5.0 million for the corresponding period ended December 31, 2007. This increase of 8% was primarily attributable to the additional staffing of several existing branches in younger markets and increased general operating expenses. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.22% for the three-month period ended December 31, 2008 from 10.27% for the three-month period ended December 31, 2007.

Interest Expense

Interest expense decreased to approximately $1.3 million for the three-month period ended December 31, 2008 from $1.6 million for the three-month period ended December 31, 2007. The average indebtedness for the three-month period ended December 31, 2008 increased to approximately $104.1 million as compared to $98.9 million for the corresponding period ended December 31, 2007. The Company s average cost of borrowed funds decreased to 4.87% for the three-month period ended December 31, 2008 as compared to 6.51% for the corresponding period ended December 31, 2007. The primary reasons the Company s average cost of funds decreased is the weighted-average 30-day LIBOR rate decreased from 5.02% for the three months ended December 31, 2007 as compared to 2.89% for the three months ended December 31, 2008 and the Company s decision, based on credit market events that transpired in October of 2008, to elect a prime rate pricing option for the month of October 2008, which resulted in a lower interest rate than the LIBOR pricing option for October of 2008. The reduction in 30-day LIBOR rates was offset in part by the Company s interest rate swap agreements, which convert a portion of the Company s floating rate debt to fixed rate debt. For further discussions regarding the Company s cost of funds and the effect of interest rate swap agreements see note 6 Interest Rate Swaps .

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Nine months ended December 31, 2008 compared to nine months ended December 31, 2007

Interest Income and Loan Portfolio

Interest income on finance receivables, predominately finance charge income, increased 7% to approximately $39.8 million for the nine-month period ended December 31, 2008, from approximately $37.3 million for the corresponding period ended December 31, 2007. Average finance receivables, net of unearned interest equaled approximately $206.8 million for the nine-month period ended December 31, 2008, an increase of 9% from approximately $189.6 million for the corresponding period ended December 31, 2007. 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 during fiscal 2008 and the first six months of fiscal 2009. The gross finance receivable balance increased 9% to approximately $291.5 million as of December 31, 2008 from $267.3 million as of December 31, 2007. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 26.23% for the nine-month period ended December 31, 2007 to 25.68% for the nine-month period ended December 31, 2008. The net portfolio yield decreased from 19.15% for the nine-month period ended December 31, 2007 to 14.57% for the corresponding period ended December 31, 2008. The gross portfolio yield decreased due to reduced accretion of discounts as compared to the prior year (see discussion under Analysis of Credit Losses below). The net portfolio yield decreased due to the above factor plus the effect of additional provision in response to increased charge-off rates.

Marketing, Salaries, Employee Benefits, Depreciation and Administrative Expenses

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $16.8 million for the nine-month period ended December 31, 2008 from approximately $15.0 million for the corresponding period ended December 31, 2007. This increase of 12% was primarily attributable to the additional staffing of several existing branches in younger markets and increased general operating expenses. Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of finance receivables, net of unearned interest, increased to 10.67% for the nine-month period ended December 31, 2008 from 10.46% for the nine-month period ended December 31, 2007.

Interest Expense

Interest expense decreased to approximately $4.1 million for the nine-month period ended December 31, 2008 from $4.8 million for the nine-month period ended December 31, 2007. The average indebtedness for the nine-month period ended December 31, 2008 increased to approximately $103.7 million as compared to $96.2 million for the corresponding period ended December 31, 2007. The Company s average cost of borrowed funds decreased to 5.28% for the nine-month period ended December 31, 2008 as compared to 6.71% for the corresponding period ended December 31, 2007. The primary reason the Company s average cost of funds decreased is the weighted-average 30-day LIBOR rate decreased from 5.23% for the nine months ended December 31, 2007 as compared to 2.67% for the nine months ended December 31, 2008. The reduction in 30-day LIBOR rates was offset in part by the Company s interest rate swap agreements, which convert a portion of the Company s floating rate debt to fixed rate debt. For further discussions regarding the Company s cost of funds and the effect of interest rate swap agreements see note 6 Interest Rate Swaps .

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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 and nine-month periods ended December 31, 2008 and 2007, less than 3% were for new vehicles. As of December 31, 2008, the average model year of vehicles collateralizing the portfolio was a 2003 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	**2008**	**2007**	**2008**	**2007**
FL	$ 8,232,199	$ 10,881,386	$ 31,900,120	$ 36,255,569
GA	2,323,341	2,024,286	8,245,818	8,997,984
NC	1,833,047	2,934,295	8,164,930	9,208,081
SC	383,500	638,304	1,672,662	2,870,616
OH	3,326,428	3,633,921	11,699,003	10,292,674
MI	746,055	446,308	2,100,454	1,338,732
VA	787,132	1,181,912	3,591,065	2,907,605
IN	1,598,370	581,405	5,163,710	2,303,757
KY	1,307,285	1,425,847	4,534,183	3,959,141
MD	158,808	980,844	1,512,474	3,300,386
AL	759,085	741,254	2,649,310	2,064,281
TN	270,181		1,478,971	
Total	$ 21,725,431	$ 25,469,762	$ 82,712,700	$ 83,498,826

	Three months ended December 31,		Nine months ended December 31,	
Contracts	**2008**	**2007**	**2008**	**2007**
Purchases	$ 21,725,431	$ 25,469,762	$ 82,712,700	$ 83,498,826
Weighted APR	23.73%	24.08%	24.05%	24.13%
Average discount	9.23%	8.34%	9.03%	8.18%
Weighted average term (months)	49	48	48	48
Average loan	$ 9,377	$ 9,316	$ 9,455	$ 9,369
Number of Contracts	2,317	2,734	8,748	8,912

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	**2008**	**2007**	**2008**	**2007**

Originations	$ 1,112,116	$ 2,252,404	$ 3,487,067	$ 6,784,701
Weighted APR	27.30%	24.89%	27.15%	25.67%
Weighted average term (months)	23	26	24	29
Average loan	$ 2,371	$ 3,090	$ 2,531	$ 3,305
Number of loans	469	729	1,378	2,053

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Analysis of Credit Losses

As of December 31, 2008, the Company had 910 active static pools. The average pool upon inception consisted of 65 Contracts with aggregate finance receivables, net of unearned interest, of approximately $602,000.

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,	
	2008	2007	2008	2007
Balance at beginning of period	$ 23,183,977	$ 19,899,906	$ 20,112,260	$ 20,638,912
Discounts acquired on new volume	1,980,990	2,077,969	7,359,920	6,705,953
Losses absorbed	(6,193,349)	(4,960,826)	(16,981,767)	(12,652,859)
Current period provision	4,390,700	2,306,620	12,485,249	4,932,197
Recoveries	452,373	433,603	1,326,309	1,383,935
Discounts accreted	(166,670)	(422,163)	(653,950)	(1,673,029)
Balance at end of period	$ 23,648,021	$ 19,335,109	$ 23,648,021	$ 19,335,109

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,	
	2008	2007	2008	2007
Balance at beginning of period	$ 483,174	$ 319,208	$ 335,057	$ 324,688
Current period provision	176,939	139,945	629,795	280,752
Losses absorbed	(121,906)	(103,963)	(454,881)	(266,450)
Recoveries	12,911	15,515	41,147	31,715
Balance at end of period	$ 551,118	$ 370,705	$ 551,118	$ 370,705

Reserves accreted into income for the three months ended December 31, 2008 and 2007, were approximately $167,000 and $422,000, respectively. Reserves accreted into income for the nine months ended December 31, 2008 and 2007, were approximately $650,000 and $1.7 million, respectively. The Company has seen deterioration in the performance of its Contract portfolio, more specifically, static pools originated since June 30, 2006 have seen an increase in the default rate when compared to the preceding years pool performance during their same liquidation cycle. The Company attributes this increase to weakness in the consumer credit cycle and weakness in employment and believes this trend will continue for the remainder of its fiscal year. The Company experienced a higher net charge-off percentage of 11.15% during the three-month period ended December 31, 2008 as compared to 9.51% for the three-month period ended December 31, 2007. The Company experienced a higher net charge-off percentage of 10.27% during the nine-month period ended December 31, 2008 as compared to 7.98% for the nine-month period ended December 31, 2007.

The average dealer discount associated with new volume for the three months ended December 31, 2008 and 2007 were 9.23% and 8.34%, respectively. The average dealer discount associated with new volume for the nine months ended December 31, 2008 and 2007 were 9.03% and 8.18%, respectively. The Company believes the increase in the average dealer discount was the result of less competition in the markets the Company is currently operating in. The Company intends to remain focused on maintaining these increased discount levels to help off-set the rising loss rates it has been experiencing.

The provision for credit losses increased from approximately $2.4 million for the three-month period ended December 31, 2007, to $4.6 million for the three-month period ended December 31, 2008. The provision for credit losses increased from approximately $5.2 million for the nine-month period ended December 31, 2007, to $13.1 million for the nine-month period ended December 31, 2008. The Company s losses absorbed as a percentage of liquidation increased from 10.35% for the three months ended December 31, 2007, to 14.62% for the three months ended December 31, 2008. The Company s losses absorbed as a percentage of liquidation increased from 8.77% for the nine months ended

December 31, 2007, to 12.90% for the nine months ended December 31, 2008. In addition, excess provisions reversed, increased from approximately $35,000 for the three-month period ended December 31, 2007 to approximately $68,000 for the three-month period ended December 31, 2008. Excess provisions reversed decreased from approximately $302,000 for the nine-month period ended December 31, 2007 to $78,000 for the nine-month period ended December 31, 2008. 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 December 2005.

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The Company anticipates losses absorbed as a percentage of liquidation will be in the 12-15% 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, terms or quality of Contracts purchased during the three and nine months ended December 31, 2008 that would have contributed to the increase in losses.

Recoveries as a percentage of charge-offs decreased from approximately 10% for the three months ended December 31, 2007 to approximately 8% for the three months ended December 31, 2008. Recoveries as a percentage of charge-offs decreased from approximately 12% for the nine months ended December 31, 2007 to approximately 9% for the nine months ended December 31, 2008.

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:

	December 31, 2008		December 31, 2007	
Contracts				
Gross balance outstanding	$ 283,571,200		$ 256,278,730	
Delinquencies				
30 to 59 days	$ 12,454,035	4.39%	$ 8,908,945	3.48%
60 to 89 days	5,022,847	1.78%	2,933,134	1.14%
90 + days	1,777,122	0.62%	1,402,143	0.55%
Total delinquencies	$ 19,254,004	6.79%	$ 13,244,222	5.17%
Direct Loans				
Gross balance outstanding	$ 7,894,781		$ 10,989,625	
Delinquencies				
30 to 59 days	$ 234,606	2.97%	$ 212,084	1.93%
60 to 89 days	124,840	1.58%	77,503	0.71%
90 + days	97,807	1.24%	91,271	0.83%
Total delinquencies	$ 457,253	5.79%	$ 380,858	3.47%

The delinquency percentage for Contracts more than thirty days past due as of December 31, 2008 was 6.79% as compared to 5.17% as of December 31, 2007. The delinquency percentage for direct loans more than thirty days past due as of December 31, 2008 was 5.79% as compared to 3.47% as of December 31, 2007.

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.

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Income Taxes

The provision for income taxes decreased to approximately $144,000 for the three months ended December 31, 2008 as compared to approximately $1.3 million for the three months ended December 31, 2007. The provision for income taxes decreased to approximately $1.6 million for the nine months ended December 31, 2008 as compared to approximately $4.6 million for the nine months ended December 31, 2007. The Company s effective tax rate increased from 37.09% for the three months ended December 31, 2007 to 38.08% for the three months ended December 31, 2008. The primary reason for this increase was the result of an increase in expenses not deductible for tax purposes during the three months ended December 31, 2008.

The Company s effective tax rate increased from 37.85% for the nine months ended December 31, 2007 to 38.09% for the nine months ended December 31, 2008. The primary reason for this increase was the result of an increase in expenses not deductible for tax purposes during the nine months ended December 31, 2008.

Liquidity and Capital Resources

The Company s cash flows are summarized as follows:

	Nine months ended December 31,	
	2008	**2007**
Cash provided by (used in):		
Operating activities	$ 16,294,883	$ 11,250,824
Investing activities (primarily purchase of Contracts)	(18,095,233)	(13,740,605)
Financing activities	1,398,035	5,695,583
Net (decrease) increase in cash	$ (402,315)	$ 3,205,802

The Company s primary use of working capital for the nine months ended December 31, 2008 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, 2008 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, 2008, the amount outstanding under the Line was approximately $101.5 million and the amount available under the Line was approximately $13.5 million.

The Company will continue to depend on the availability of the Line, together with cash from operations, to finance future operations. Amounts outstanding under the Line have (decreased) increased by approximately ($4.6) million and $1.6 million during the three and nine months ended December 31, 2008, respectively. The growth of the Line is principally related to funding the purchase of Contracts and is consistent with the growth of finance receivables. The Company was contemplating executing an amendment to the Line, which would have increased the size of the Line and extended the maturity date. However, as U.S. and global market and economic conditions continue to be disrupted and volatile, particularly in the financial sector, the Company has elected not to amend its Line at this time. The primary reasons are the uncertainty of demand for the Company s contract procurement program and the increased pricing associated with increasing the size of the Line and extending the maturity date. Continued disruption in U.S. and global markets could adversely affect the Company s ability to increase the size of the Line and extend the maturity date or refinance indebtedness. Any new or renewed credit facility may be under terms that are not as favorable as the current credit facility. Our inability to obtain additional financing on favorable terms, if at all, would limit our ability to grow and could have a material adverse effect on our results of operations and business.

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 the maturity date of the Line, which is November 30, 2010. 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 our 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.

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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, 2008, approximately 79% of the Company s borrowings under the Line were subject to interest rate swap agreements. These swap agreements have maturities ranging from October 2, 2009 through February 2, 2011.

Future Expansion

The Company currently operates a total of forty-eight branch locations in twelve states, including nineteen in Florida, six in Ohio, five 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.

Due to economic conditions and the uncertainty surrounding consumer demand for new and used vehicles, the Company does not anticipate any further expansion during the remaining fiscal year. The Company will continue to evaluate markets it currently operates within and some branch consolidation is possible.

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 the three months ended December 31, 2008, the Company undesignated all of its interest rate swaps as cash flow hedges. (See note 6 Interest Rate Swaps) 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, 2008, 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.

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 9, 2009

/s/ Peter L. Vosotas
Peter L. Vosotas
Chairman of the Board, President,
Chief Executive Officer and Director

Date: February 9, 2009

/s/ Ralph T. Finkenbrink
Ralph T. Finkenbrink
Senior Vice President,
Chief Financial Officer and Director

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EXHIBIT INDEX

Exhibit No.	Description
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