NICHOLAS FINANCIAL INC
Form 10-Q
November 12, 2013
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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, 2013

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

Commission file number: 0-26680

NICHOLAS FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

British Columbia, Canada	**8736-3354**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

2454 McMullen Booth Road, Building C

Clearwater, Florida	**33759**
(Address of Principal Executive Offices)	**(Zip Code)**

(727) 726-0763

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes 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	x
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 x

As of November 1, 2013, the registrant had 12,203,769 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Consolidated Balance Sheets

	September 30, 2013 (Unaudited)	March 31, 2013
Assets		
Cash	$ 4,473,682	$ 2,797,716
Finance receivables, net	260,494,081	249,825,801
Assets held for resale	2,012,361	1,203,664
Income taxes receivable	847,167	102,999
Prepaid expenses and other assets	678,150	736,746
Property and equipment, net	749,358	741,581
Interest rate swap agreements	135,245	
Deferred income taxes	7,211,508	8,426,961
Total assets	$ 276,601,552	$ 263,835,468
Liabilities and shareholders equity		
Line of credit	$ 131,000,000	$ 125,500,000
Drafts payable	2,118,901	2,096,311
Accounts payable and accrued expenses	6,808,894	7,405,579
Interest rate swap agreements	56,454	504,852
Deferred revenues	1,870,092	1,363,630
Total liabilities	141,854,341	136,870,372
Shareholders equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 12,198,279 and 12,154,069 shares issued and outstanding, respectively	30,647,744	30,031,548
Retained earnings	104,099,467	96,933,548
Total shareholders equity	134,747,211	126,965,096
Total liabilities and shareholders equity	$ 276,601,552	$ 263,835,468

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

	Three months ended September 30,		Six months ended September 30,	
	2013	**2012**	**2013**	**2012**
Revenue:				
Interest and fee income on finance receivables	$ 20,943,161	$ 20,696,241	$ 41,412,533	$ 41,114,198
Sales	5,763	9,180	12,126	18,949
	20,948,924	20,705,421	41,424,659	41,133,147
Expenses:				
Cost of sales	2,541	1,809	4,836	5,172
Marketing	363,515	355,498	759,589	729,830
Salaries and employee benefits	4,831,559	4,563,604	9,683,009	9,088,090
Administrative	2,736,298	2,267,648	5,334,949	4,366,586
Provision for credit losses	3,973,104	3,261,721	6,614,895	6,364,987
Dividend tax	69,538	72,042	142,557	132,458
Depreciation	76,819	70,253	152,154	142,720
Interest expense	1,442,898	1,250,231	2,847,804	2,442,371
Change in fair value of interest rate swap agreements	249,616	474,019	(583,643)	683,120
	13,745,888	12,316,825	24,956,150	23,955,334
Operating income before income taxes	7,203,036	8,388,596	16,468,509	17,177,813
Income tax expense	2,886,484	3,238,458	6,451,464	6,620,219
Net income	$ 4,316,552	$ 5,150,138	$ 10,017,045	$ 10,557,594
Earnings per share:				
Basic	$ 0.36	$ 0.43	$ 0.83	$ 0.88
Diluted	$ 0.35	$ 0.42	$ 0.82	$ 0.87
Dividends declared per share	$ 0.12	$ 0.12	$ 0.24	$ 0.22

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

	Six months ended September 30, 2013	Six months ended September 30, 2012
Cash flows from operating activities		
Net income	$ 10,017,045	$ 10,557,594
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	152,154	142,720
Gain on sale of property and equipment	(21,800)	(5,615)
Provision for credit losses	6,614,895	6,364,987
Amortization of dealer discounts	(6,108,055)	(6,082,112)
Deferred income taxes	1,215,453	628,705
Share-based compensation	261,444	575,404
Change in fair value of interest rate swap agreements	(583,643)	683,120
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	58,596	201,685
Accounts payable and accrued expenses	(596,685)	408,383
Income taxes receivable	(744,168)	(785,353)
Deferred revenues	506,462	46,861
Net cash provided by operating activities	10,771,698	12,736,379
Cash flows from investing activities		
Purchase and origination of finance receivables	(78,220,371)	(71,122,887)
Principal payments received	67,045,251	64,080,392
Increase in assets held for resale	(808,697)	(268,649)
Purchase of property and equipment	(178,912)	(149,566)
Proceeds from sale of property and equipment	40,781	6,670
Net cash used in investing activities	(12,121,948)	(7,454,040)
Cash flows from financing activities		
Net draws on or repayment from line of credit	5,500,000	(2,000,000)
Change in drafts payable	22,590	(37,216)
Payment of cash dividends	(2,851,126)	(2,649,163)
Proceeds from exercise of stock options	217,673	220,136
Excess tax benefits from exercise of stock options and vesting of other share awards	137,079	103,400

Net cash provided (used) by financing activities	3,026,216	(4,362,843)
Net increase in cash	1,675,966	919,496
Cash, beginning of period	2,797,716	2,803,054
Cash, end of period	$ 4,473,682	$ 3,722,550

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying consolidated balance sheet as of March 31, 2013, which has been derived from audited financial statements, and the accompanying unaudited interim 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 (U.S. 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 U.S. GAAP for complete consolidated financial statements, although the Company believes that the disclosures made are adequate to ensure the information is 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, 2014. It is suggested that these 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, 2013 as filed with the Securities and Exchange Commission on June 14, 2013. The March 31, 2013 consolidated balance sheet included herein has been derived from the March 31, 2013 audited consolidated balance sheet included in the aforementioned Form 10-K.

The preparation of consolidated financial statements in conformity with U.S. 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 and the fair value of interest rate swap agreements.

As previously disclosed in the Company s Annual Report on Form 10-K for the year ended March 31, 2013, the Company made error corrections for departures from U.S. GAAP and revised previously reported amounts. One of the corrections is related to the accounting treatment for dealer discounts. A dealer discount represents the difference between the amount of a finance receivable, net of unearned interest, based on the terms of a Contract with the borrower, and the amount of money the Company actually pays the dealer for the Contract. Prior to the correction, Contracts were recorded at the net initial investment with the gross Contract balance recorded offset by the dealer discounts which were recorded as an allowance for credit losses for the acquired Contracts. The Company determined that this accounting treatment was incorrect as U.S. GAAP prohibits carrying over valuation allowances in the initial accounting for acquired loans. Accordingly, the Company has now applied an acceptable method under U.S. GAAP, deferring and netting dealer discounts against finance receivables as unearned discounts, and recognizing dealer discounts into income as an adjustment to yield over the life of the loan using the interest method.

The allowance for loan losses is now established solely through charges to earnings through the provision for credit losses. The Company has evaluated the significance of the departure from U.S. GAAP to the consolidated financial statements. Under both the former accounting policy and U.S. GAAP, the dealer discount remains a reduction of gross finance receivables in arriving at the carrying amount of finance receivables, net. Accordingly, finance receivables continue to be initially recorded at the net initial investment at the time of purchase. Subsequently, the allowance for credit losses is maintained at an amount that reduces the net carrying amount of finance receivables. The change in this accounting presentation does not result in a change to the net carrying amount of finance receivables or to net income as historical losses incurred, and estimated incurred losses as of the balance sheet date, are generally in excess of the original dealer discount. The removal of the dealer discount from the allowance requires an equal replacement of provision expense as that portion of the allowance is necessary to absorb probable incurred losses. This correction also did not have an impact on previously reported assets, liabilities, working capital, equity, earnings, or cash flows.

The second correction related to the accounting treatment and presentation of certain fees charged to dealers and costs incurred in purchasing loans from dealers. The costs related principally to evaluating borrowers subject to Contracts in relation to the Company s underwriting guidelines in making a determination to acquire Contracts. Prior to the correction, fees charged to dealers were reduced by certain costs incurred to purchase Contracts, deferred on a net basis and then amortized into income over the lives of the loans using the interest method. Under U.S. GAAP, the fees charged to dealers are considered to be a part of the unearned dealer discount as they are a determinant of the net amount of cash paid to the dealer. Further, U.S. GAAP specifies that costs incurred in connection with acquiring purchased loans or committing to purchase loans shall be charged to expense as incurred. Such costs do not qualify as origination costs to be deferred as the Contracts have already been originated by the dealers.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

1. Basis of Presentation (continued)

The Company evaluated the significance of the departures from U.S. GAAP to the consolidated financial statements. After an adjustment to beginning equity and the opening balance of unearned dealer discounts, net of tax, for the initial period presented, there is a limited effect on earnings and no impact on cash flows.

The changes to consolidated financial statement captions and earnings per share, if any, are as follows:

Consolidated Balance Sheet	September 30, 2012 as Reported	Correction	September 30, 2012 as Corrected
Finance receivables, net	$ 249,072,304	$ (1,059,253)	$ 248,013,051
Deferred income taxes	8,089,112	405,483	8,494,595
Retained earnings, September 30, 2012	115,399,320	(653,770)	114,745,550

Consolidated Statements of Income	Three months ended September 30, 2012	Three months ended September 30, 2012 as Reported	Correction	Three months ended September 30, 2012 as Corrected
Interest and fee income on finance receivables		$ 17,761,998	$ 2,934,243	$ 20,696,241
Provision for credit losses		308,340	2,953,381	3,261,721
Operating income		8,407,734	(19,138)	8,388,596
Income tax expense		3,245,784	(7,326)	3,238,458
Net income		5,161,950	(11,812)	5,150,138
Earnings per share basic		0.43		0.43
Earnings per share diluted		0.42		0.42

Consolidated Statements of Income	Six months ended September 30, 2012	Six months ended September 30, 2012 as Reported	Correction	Six months ended September 30, 2012 as Corrected
Interest and fee income on finance receivables		$ 35,032,086	$ 6,082,112	$ 41,114,198
Provision for credit losses		318,712	6,046,275	6,364,987
Operating income		17,141,976	35,837	17,177,813
Income tax expense		6,606,501	13,718	6,620,219

Net income		10,535,475	22,119	10,557,594
Earnings per share	basic	0.88		0.88
Earnings per share	diluted	0.86	0.01	0.87

Consolidated Statements of Cash Flows (Operating Activities)	Six months ended September 30, 2012 as Reported	Correction	Six months ended September 30, 2012 as Corrected
Net income	$ 10,535,475	$ 22,119	$ 10,557,594
Provision for credit losses	318,712	6,046,275	6,364,987
Deferred income taxes	614,987	13,718	628,705
Amortization of dealer discounts		(6,082,112)	(6,082,112)
Net cash provided by operating activities	12,736,379		12,736,379

In addition the Company has corrected these errors in the finance receivables disclosure in Note 4. The following table sets forth a reconciliation of the changes in the allowance for credit losses on Contracts:

	Three months ended September 30, 2012 as Reported	Correction	Three months ended September 30, 2012 as Corrected
Balance at beginning of year	$ 35,645,655	$ (16,003,999)	$ 19,641,656
Discounts acquired on new volume	2,843,382	(2,843,382)	
Provision for credit losses	293,618	2,953,380	3,246,998
Losses absorbed	(5,295,524)		