NICHOLAS FINANCIAL INC
Form 10-Q
February 09, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED December 31, 2016

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 **(State or Other Jurisdiction of** **Incorporation or Organization)**	**8736-3354** **(I.R.S. Employer** **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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

As of February 1, 2017, 12,495,089 shares, no par value, of the Registrant were outstanding (of which 4,713,804 shares were held by the Registrant s principal operating subsidiary and pursuant to applicable law, not entitled to vote and 7,781,285 shares were entitled to vote).

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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

Consolidated Balance Sheets

(In thousands)

	December 31, 2016 (Unaudited)	March 31, 2016
Assets		
Cash	**$ 3,664**	$ 1,849
Finance receivables, net	**321,757**	311,837
Assets held for resale	**2,976**	2,148
Income taxes receivable		593
Prepaid expenses and other assets	**632**	977
Property and equipment, net	**1,580**	1,290
Deferred income taxes	**7,232**	6,615
Total assets	**$ 337,841**	$ 325,309
Liabilities and shareholders equity		
Line of credit	**$ 214,340**	$ 211,000
Drafts payable	**1,687**	1,499
Interest rate swap agreements	**21**	205
Accounts payable and accrued expenses	**7,391**	5,839
Income taxes payable	**605**	
Deferred revenues	**4,003**	3,917
Total liabilities	**228,047**	222,460
Shareholders equity		
Preferred stock, no par: 5,000 shares authorized; none issued		
Common stock, no par: 50,000 shares authorized; 12,492 and 12,466 shares issued, respectively; and 7,778 and 7,752 shares outstanding, respectively	**33,753**	33,287
Treasury stock: 4,714 common shares, at cost	**(70,459)**	(70,459)
Retained earnings	**146,500**	140,021
Total shareholders equity	**109,794**	102,849
Total liabilities and shareholders equity	**$ 337,841**	$ 325,309

See accompanying notes.

Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)

	Three months ended December 31,		Nine months ended December 31,	
	2016	**2015**	**2016**	**2015**
Interest and fee income on finance receivables	**$ 22,044**	$ 22,757	**$ 67,606**	$ 67,469
Expenses:				
Marketing	**369**	384	**1,100**	1,140
Salaries and employee benefits	**5,041**	5,539	**16,363**	16,623
Professional Fees	**386**	306	**1,004**	1,131
Administrative	**2,546**	2,324	**7,748**	7,176
Provision for credit losses	**8,796**	7,599	**23,966**	18,766
Depreciation	**142**	120	**413**	334
Interest expense	**2,258**	2,311	**6,745**	6,750
Change in fair value of interest rate swap agreements	**(81)**	(251)	**(184)**	(128)
	19,457	18,332	**57,155**	51,792
Operating income before income taxes	**2,587**	4,425	**10,451**	15,677
Income tax expense	**981**	1,698	**3,972**	6,024
Net income	**$ 1,606**	$ 2,727	**$ 6,479**	$ 9,653
Earnings per share:				
Basic	**$ 0.21**	$ 0.36	**$ 0.83**	$ 1.27
Diluted	**$ 0.21**	$ 0.35	**$ 0.83**	$ 1.24

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Nine months ended December 31,	
	2016	**2015**
Cash flows from operating activities		
Net income	**$ 6,479**	$ 9,653
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**413**	334
Gain on sale of property and equipment	**(13)**	(12)
Provision for credit losses	**23,966**	18,766
Amortization of dealer discounts	**(9,830)**	(9,886)
Deferred income taxes	**(626)**	(296)
Share-based compensation	**474**	416
Change in fair value of interest rate swap agreements	**(184)**	(128)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	**345**	396
Accounts payable and accrued expenses	**1,552**	(2,202)
Income taxes payable and receivable	**1,198**	(306)
Deferred revenues	**86**	657
Net cash provided by operating activities	**23,860**	17,392
Cash flows from investing activities		
Purchase and origination of finance receivables	**(118,276)**	(131,416)
Principal payments received	**94,220**	101,126
Increase in assets held for resale	**(828)**	(185)
Purchase of property and equipment	**(728)**	(878)
Proceeds from sale of property and equipment	**38**	48
Net cash used in investing activities	**(25,574)**	(31,305)
Cash flows from financing activities		
Increase on line of credit	**3,340**	14,000
Change in drafts payable	**188**	(476)
Payment of debt costs		(25)
Expenses related to prior purchase of treasury shares		(50)
Proceeds from exercise of stock options	**1**	76
Excess tax benefits from share-based compensation		6

Net cash provided by financing activities		**3,529**		13,531
Net increase (decrease) in cash		**1,815**		(382)
Cash, beginning of period		**1,849**		3,388
Cash, end of period	**$**	**3,664**	$	3,006
Supplemental Disclosure of noncash investing and financing activities:				
Tax deficiency from share awards	**$**	**(9)**	$	

See accompanying notes.

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, 2016, 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, 2017. 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, 2016 as filed with the Securities and Exchange Commission on June 14, 2016. The March 31, 2016 consolidated balance sheet included herein has been derived from the March 31, 2016 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.

2. Revenue Recognition

Finance receivables consist of automobile finance installment contracts (Contracts) and direct consumer loans (Direct Loans). Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan enters bankruptcy status, is contractually delinquent for 61 days or more or the collateral is repossessed, whichever is earlier. Chapter 13 bankruptcy accounts are accounted for under the cost-recovery method. Interest income on Chapter 13 bankruptcy accounts does not resume until all principal amounts are recovered (see Note 4).

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 lender, the wholesale value of the vehicle and competition in any given market. In making decisions regarding the purchase of a particular Contract the Company considers the following factors related to the borrower: place and length of residence; current and prior job status; history in making installment payments for automobiles; current income; and credit history. In addition, the Company examines its prior experience with Contracts purchased from the dealer from which the Company is purchasing the Contract, and the value of the automobile in relation to the purchase price and the term of the Contract. The entire amount of discount is amortized as an adjustment to yield

using the interest method over the life of the loan. The average dealer discount associated with new volume for the three months ended December 31, 2016 and 2015 was 6.87% and 7.59%, respectively in relation to the total amount financed. The average dealer discount associated with new volume for the nine months ended December 31, 2016 and 2015 was 7.00% and 7.56%, respectively.

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

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

The Company s net costs for originating Direct Loans are deferred and recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

3. Earnings Per Share

The Company has granted stock compensation awards with nonforfeitable dividend rights which are considered participating securities. As such, earnings per share is calculated using the two-class method. Basic earnings per share is calculated by dividing net income allocated to common shareholders by the weighted average number of common shares outstanding during the period, which excludes the participating securities. Diluted earnings per share includes the dilutive effect of additional potential common shares from stock compensation awards. Earnings per share have been computed based on the following weighted average number of common shares outstanding:

	Three months ended December 31, (In thousands, except per share amounts)		Nine months ended December 31, (In thousands, except per share amounts)	
	2016	**2015**	**2016**	**2015**
Numerator:				
Net income per consolidated statements of income	**$ 1,606**	$ 2,727	**$ 6,479**	$ 9,653
Less: Allocation of earnings to participating securities	**(22)**		**(76)**	
Net income allocated to common stock	**1,584**	$ 2,727	**6,403**	$ 9,653
Basic earnings per share computation:				
Net income allocated to common stock	**$ 1,584**	$ 2,727	**$ 6,403**	$ 9,653
Weighted average common shares outstanding, including shares considered participating securities	**7,697**	7,623	**7,763**	7,620
Less: Weighted average participating securities outstanding	**(107)**		**(91)**	
Weighted average shares of common stock	**7,590**	7,623	**7,672**	7,620
Basic earnings per share	**$ 0.21**	0.36	**$ 0.83**	1.27
Diluted earnings per share computation:				
Net income allocated to common stock	**$ 1,584**	$ 2,727	**$ 6,403**	$ 9,653
Undistributed earnings re-allocated to participating securities				

Numerator for diluted earnings per share	**$ 1,584**	$ 2,727	**$ 6,403**	$ 9,653
Weighted average common shares outstanding for basic earnings per share	**7,590**	7,623	**7,672**	7,620
Incremental shares from stock options	**60**	148	**60**	158
Weighted average shares and dilutive potential common shares	**7,650**	7,771	**7,732**	7,778
Diluted earnings per share	**$ 0.21**	$ 0.35	**$ 0.83**	$ 1.24

Diluted earnings per share do not include the effect of certain stock options as their impact would be anti-dilutive. For the three and nine months ended December 31, 2016 and 2015, potential shares of common stock from stock options totaling 160,000 and 165,000, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables

Finance receivables consist of automobile finance installment Contracts and Direct Loans and are detailed as follows:

	(In thousands)	
	December 31, 2016	**March 31, 2016**
Finance receivables, gross contract	**$ 515,316**	$ 498,130
Unearned interest	**(161,645)**	(155,257)
Finance receivables, net of unearned interest	**353,671**	342,873
Unearned dealer discounts	**(17,166)**	(18,023)
Finance receivables, net of unearned interest and unearned dealer discounts	**336,505**	324,850
Allowance for credit losses	**(14,748)**	(13,013)
Finance receivables, net	**$ 321,757**	$ 311,837

Contracts and Direct Loans each comprise a portfolio segment. The following tables present selected information on the entire portfolio of the Company:

	As of December 31,	
	2016	**2015**
Contract Portfolio		
Weighted APR	22.43%	22.71%
Weighted average discount	7.48%	7.70%
Weighted average term (months)	57	56
Number of active contracts	37,834	38,013

	As of December 31,	
	2016	**2015**

Direct Loan Portfolio		
Weighted APR	25.69%	25.75%
Weighted average term (months)	33	32
Number of active contracts	3,023	3,185

Each portfolio segment consists of smaller balance homogeneous loans which are collectively evaluated for impairment.

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

	Three months ended December 31, (In thousands)		**Nine months ended December 31, (In thousands)**	
	2016	**2015**	**2016**	**2015**
Balance at beginning of period	**$ 12,925**	$ 10,955	**$ 12,265**	$ 11,325
Current period provision	**8,701**	7,437	**23,723**	18,402
Losses absorbed	**(8,247)**	(7,584)	**(23,815)**	(20,454)
Recoveries	**570**	694	**1,776**	2,229
Balance at end of period	**$ 13,949**	$ 11,502	**$ 13,949**	$ 11,502

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of December 31, 2016, the average model year of vehicles collateralizing the portfolio was a 2008 vehicle. The Company utilizes a static pool approach to track portfolio performance. If the allowance for credit losses is determined to be inadequate for a static pool, then an additional charge to income through the provision is used to maintain adequate reserves based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, and current economic conditions. Such evaluation, considers among other matters, the estimated net realizable 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 allowance for credit losses.

The following table sets forth a reconciliation of the changes in the allowance for credit losses on Direct Loans:

	Three months ended December 31, (In thousands)		Nine months ended December 31, (In thousands)	
	2016	**2015**	**2016**	**2015**
Balance at beginning of period	**$ 774**	$ 780	**$ 748**	$ 703
Current period provision	**95**	162	**243**	364
Losses absorbed	**(73)**	(83)	**(217)**	(224)
Recoveries	**3**	1	**25**	17
Balance at end of period	**$ 799**	$ 860	**$ 799**	$ 860

Direct Loans are originated directly between the Company and the consumer. These loans are typically for amounts ranging from $1,000 to $10,000 and are generally secured by a lien on an automobile, watercraft or other permissible tangible personal property. The majority of Direct Loans are originated with current or former customers under the Company s automobile financing program. The typical Direct Loan represents a significantly better credit risk than our typical Contract due to the customer s historical payment history with the Company. In deciding whether or not to make a loan, the Company considers the individual s credit history, job stability, income and impressions created during a personal interview with a Company loan officer. Additionally, because most of Direct Loans made by the Company to date have been made to borrowers under Contracts previously purchased by the Company, the payment history of the borrower under the Contract is a significant factor in making the loan decision. As of December 31, 2016, loans made by the Company pursuant to its Direct Loan program constituted approximately 2% of the aggregate principal amount of the Company s loan portfolio. Changes in the allowance for credit losses for both Contracts and

Direct Loans were driven by current economic conditions and trends over several reporting periods which are useful in estimating future losses and overall portfolio performance.

A performing account is defined as an account that is less than 61 days past due. A non-performing account is defined as an account that is contractually delinquent for 61 days or more and the accrual of interest income is suspended. As of September 30, 2016, when an account is 180 days contractually delinquent, the account is written off. This change aligns the Company s charge-off policy with best practices within the subprime auto financing segment, and had an immaterial impact on losses absorbed and the allowance for credit losses. Prior to September 2016, accounts that were 120 days contractually delinquent were written off. See Item 2 for more discussion. Upon notification of a Chapter 13 bankruptcy, an account is put into bankruptcy status and monitored for collection with other Chapter 13 bankruptcy accounts. In the event the debtors balance has been reduced by the bankruptcy court, the Company will record a loss equal to the amount of principal balance reduction. The remaining balance will be reduced as payments are received by the bankruptcy court. In the event an account is dismissed from bankruptcy, the Company will decide, based on several factors, to begin repossession proceedings or to allow the customer to begin making regularly scheduled payments.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

The following table is an assessment of the credit quality by creditworthiness:

	(In thousands)			
	December 31, 2016		**December 31, 2015**	
	Contracts	Direct Loans	Contracts	Direct Loans
Performing accounts	**$ 462,569**	**$ 11,231**	$ 467,285	$ 11,932
Non-performing accounts	**36,980**	**280**	11,112	100
Total	**$ 499,549**	**$ 11,511**	$ 478,397	$ 12,032
Chapter 13 bankruptcy accounts	**4,220**	**36**	4,341	38
Finance receivables, gross contract	**$ 503,769**	**$ 11,547**	$ 482,738	$ 12,070

The following tables present certain information regarding the delinquency rates experienced by the Company with respect to Contracts and under its Direct Loans, excluding Chapter 13 bankruptcy accounts:

	(In thousands)				
Contracts	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
December 31, 2016	**$ 499,549**	**$ 35,184**	**$ 17,263**	**$ 19,717**	**$ 72,164**
		7.04%	**3.46%**	**3.95%**	**14.45%**
December 31, 2015	$ 478,397	$ 23,971	$ 7,030	$ 4,082	$ 35,083
		5.01%	1.47%	0.85%	7.33%

Direct Loans	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
December 31, 2016	**$ 11,511**	**$ 282**	**$ 155**	**$ 125**	**$ 562**
		2.45%	**1.34%**	**1.09%**	**4.88%**
December 31, 2015	$ 12,032	$ 212	$ 63	$ 37	$ 312

1.76%	0.53%	0.31%	2.60%

5. Line of Credit

The Company has a line of credit facility (the Line) up to $225.0 million, which expires on January 30, 2018. Prior to December 30, 2016 the pricing on the Line was 300 basis points above 30 day LIBOR with a 1% floor on LIBOR. Effective December 30, 2016, the Company executed an amendment to this existing Line which provides temporary adjustments to the calculation of availability and increases the pricing of the Line to 350 basis points above 30 day LIBOR with the 1% floor on LIBOR (4.50% at December 31, 2016 and 4.00% at March 31, 2016). These temporary adjustments will be in place through June 30, 2017. Pledged as collateral for this Line are all the assets of the Company. The outstanding amount of the Line was $214.3 million and $211.0 million as of December 31, 2016 and March 31, 2016, respectively. The amount available under the Line was $10.7 million and $14.0 million as of December 31, 2016 and March 31, 2016, respectively.

The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. As of December 31, 2016, the Company was in compliance with all debt covenants.

6. Interest Rate Swap Agreements

The Company utilizes interest rate swap agreements to manage exposure to variability in expected cash flows attributable to interest rate risk. The interest rate swap agreements convert a portion of the floating rate debt to a fixed rate, more closely matching the interest rate characteristics of finance receivables.

As of the nine months ended December 31, 2016 and 2015, no new contracts were initiated and no contracts matured.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements (continued)

The Company currently has two interest rate swap agreements. A June 4, 2012 interest rate swap agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 1% and receives payments from the counterparty on the 1-month LIBOR rate. This interest rate swap agreement had an effective date of June 13, 2012 and a notional amount of $25.0 million. A July 30, 2012 agreement provides for a five-year interest rate swap in which the Company pays a fixed rate of 0.87% and receives payments from the counterparty on the 1-month LIBOR rate. This interest rate swap agreement had an effective date of August 13, 2012 and a notional amount of $25.0 million.

The locations and amounts of losses in income are as follows:

	Three months ended December 31, (In thousands)		Nine months ended December 31, (In thousands)	
	2016	**2015**	**2016**	**2015**
Periodic change in fair value of interest rate swap agreements	**$ (81)**	$ (251)	**$ (184)**	$ (128)
Periodic settlement differentials included in interest expense	**45**	90	**163**	279
(Gain) loss recognized in income	**$ (36)**	$ (161)	**$ (21)**	$ 151

Net realized losses from the interest rate swap agreements were recorded in the interest expense line item of the consolidated statements of income. The following table summarizes the average variable rates received and average fixed rates paid under the swap agreements.

	Three months ended December 31,		Nine months ended December 31,	
	2016	**2015**	**2016**	**2015**
Variable rate received	**0.58%**	0.24%	**0.51%**	0.21%
Fixed rate paid	**0.94%**	0.94%	**0.94%**	0.94%

7. Income Taxes

The provision for income taxes decreased to approximately $1.0 million for the three months ended December 31, 2016 from approximately $1.7 million for the three months ended December 31, 2015. The Company s effective tax rate decreased to 37.93% for the three months ended December 31, 2016 from 38.38% for the three months ended December 31, 2015. The provision for income taxes decreased to approximately $4.0 million for the nine months ended December 31, 2016 from approximately $6.0 million for the nine months ended December 31, 2015. The Company s effective tax rate decreased to 38.01% for the nine months ended December 31, 2016 from 38.42% for the nine months ended December 31, 2015.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Fair Value Disclosures

The Company measures specific assets and liabilities at fair value, which is an exit price, representing the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When applicable, the Company utilizes market data or assumptions that market participants would use in pricing the asset or liability under a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs about which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The Company estimates the fair value of interest rate swap agreements 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 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.

	Fair Value Measurement Using (In thousands)			
Description	Level 1	Level 2	Level 3	Fair Value
Interest rate swap agreements:				
December 31, 2016 liabilities:	**$**	**$ (21)**	**$**	**$ (21)**
March 31, 2016 liabilities:	$	$ (205)	$	$ (205)

Financial Instruments Not Measured at Fair Value

The Company s financial instruments consist of cash, finance receivables and the Line. For each of these financial instruments, the carrying value approximates fair value.

Finance receivables, net approximates fair value based on the price paid to acquire Contracts. The price paid reflects competitive market interest rates and purchase discounts for the Company s chosen credit grade in the economic environment. This market is highly liquid as the Company acquires individual loans on a daily basis from dealers. The initial terms of the Contracts generally range from 12 to 72 months. The initial terms of the Direct Loans generally range from 12 to 60 months. In addition, there have been minimal changes in interest rates and purchase discounts related to these types of loans due to the competitive nature of the current market. If liquidated outside of the normal course of business, the amount received may not be the carrying value.

Based on current market conditions, any new or renewed credit facility would contain pricing that approximates the Company s current Line. Based on these market conditions, the fair value of the Line as of December 31, 2016 was estimated to be equal to the book value.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Fair Value Disclosures (continued)

	(In thousands)				
	Fair Value Measurement Using			Fair	Carrying
Description	**Level 1**	**Level 2**	**Level 3**	**Value**	**Value**
Cash:					
December 31, 2016	**$ 3,664**	**$**	**$**	**$ 3,664**	**$ 3,664**
March 31, 2016	$ 1,849	$	$	$ 1,849	$ 1,849
Finance receivables:					
December 31, 2016	**$**	**$**	**$ 321,757**	**$ 321,757**	**$ 321,757**
March 31, 2016	$	$	$ 311,837	$ 311,837	$ 311,837
Line of credit:					
December 31, 2016	**$**	**$ 214,340**	**$**	**$ 214,340**	**$ 214,340**
March 31, 2016	$	$ 211,000	$	$ 211,000	$ 211,000

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 have any assets or liabilities measured at fair value on a nonrecurring basis as of December 31, 2016 and March 31, 2016.

9. Contingencies

The Company currently is not a party to any pending legal proceedings other than ordinary routine litigation incidental to its business, none of which, if decided adversely to the Company, would, in the opinion of management, have a material adverse effect on the Company s financial condition or results of operations.

10. Recently Issued Accounting Standards

In August 2016, the Financial Accounting Standards Board (FASB) issued the Accounting Standards Update (ASU) 2016-15 *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payment.* The new guidance focuses on making the Statement of Cash Flows more uniform for companies. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of the adoption of this ASU on the consolidated financial statements.

In June 2016, the FASB issued the ASU 2016-13 *Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. The new guidance requires organizations to measure all expected credit

losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. The ASU also requires additional disclosures related to estimates and judgments used to measure all expected credit losses. The new guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of the adoption of this ASU on the consolidated financial statements.

In March 2016, the FASB issued the ASU 2016-09, *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting,* which is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities,

Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

10. Recently Issued Accounting Standards (continued)

and classification on the statement of cash flows. For public entities, ASU 2016-09 is effective for annual periods beginning after December 15, 2016, including interim periods within those fiscal years. Early application is permitted. The Company is currently evaluating the impact of the adoption of this ASU on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases* , intended to improve financial reporting about leasing transactions. The ASU affects all companies and other organizations that lease assets such as real estate, airplanes, and manufacturing equipment. The ASU will require organizations that lease assets referred to as lessees to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases. The accounting by organizations that own the assets leased by the lessee also known as lessor accounting will remain largely unchanged from current U.S. GAAP. ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. The Company is currently evaluating the impact of the adoption of this ASU on the consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, *Financial Instruments Recognition and Measurement of Financial Assets and Liabilities*, which is intended to improve the recognition and measurement of financial instruments by requiring: equity investments (other than equity method or consolidation) to be measured at fair value with changes in fair value recognized in net income; public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes; separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (i.e., securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements; eliminating the requirement to disclose the fair value of financial instruments measured at amortized cost for organizations that are not public business entities; eliminating the requirement for public business entities to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet; and requiring a reporting organization to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk (also referred to as own credit) when the organization has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. This ASU is effective for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. This ASU permits early adoption of the instrument-specific credit risk provision. The Company is currently evaluating the impact of the pending adoption of this ASU on the Company s consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* . The ASU requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU, and all subsequently issued clarifying ASUs, will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. On July 9, 2015, the FASB approved the deferral of the effective

date of ASU 2014-09 by one year. As a result, ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. The ASU would permit public entities to adopt the ASU early, but not before the original effective date (i.e., annual periods beginning after December 15, 2016). The Company has not yet selected a transition method and is currently evaluating the impact of the pending adoption of this ASU on the Company s consolidated financial statements.

The Company does not believe there are any other recently issued accounting standards that have not yet been adopted that will have a material impact on the Company s consolidated financial statements.

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 , will , may , believe , and similar expressions are intended to i forward-looking statements. Although Nicholas Financial, Inc. (the Company, we, us, or our) 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 on favorable terms, the degree and nature of competition and its effects on the Company s ability to maintain profit margins at acceptable levels or generate net income at all, demand for consumer financing in the markets served by the Company, the Company s products and services, changes in the default rates experienced on automobile finance installment contracts (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 and to expand into new markets, and the Company s ability to, to recruit and retain qualified employees. 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 Forms 10-K, 10-Q, 8-K and annual reports to shareholders.

Litigation and Legal Matters

See Item 1. Legal Proceedings in Part II of this quarterly report below.

Regulatory Developments

As previously reported, Title X of the Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB), which became operational on July 21, 2011. Under the Dodd-Frank Act, the CFPB has regulatory, supervisory and enforcement powers over providers of consumer financial products, such as Contracts and the direct consumer loans (Direct Loans) that we offer, including explicit supervisory authority to examine, audit, and investigate companies offering a consumer financial product such as ourselves. Although the Dodd-Frank Act expressly provides that the CFPB has no authority to establish usury limits, some consumer advocacy groups have suggested that certain forms of alternative consumer finance products, such as installment loans, should be a regulatory priority and it is possible that at some time in the future the CFPB could propose and adopt rules making such lending or other products that we may offer materially less profitable or impractical. Further, the CFPB may target specific features of loans by rulemaking that could cause us to cease offering certain products. Any such rules could have a material adverse effect on our business, results of operations and financial condition. The CFPB could also adopt rules imposing new and potentially burdensome requirements and limitations with respect to any of our current or future lines of business, which could have a material adverse effect on our operations and financial performance.

In June 2015, the CFPB published a rule expanding their supervision and examination of non-depository larger participants in the automobile finance business, including us. Since we are deemed a larger participant, we are subject to supervision and examination by the CFPB. The CFPB s stated objectives of such examinations are: to assess the quality of a larger participant s compliance management systems for preventing violations of federal consumer financial laws; to identify acts or practices that materially increase the risk of violations of federal consumer finance laws and associated harm to consumers; and to gather facts that help determine whether the larger participant engages in acts or practices that are likely to violate federal consumer financial laws in connection with its automobile finance business. Thus, as a larger participant, we will be subject to examination by the CFPB for compliance with, among other Federal consumer financial laws, the applicable provisions of the Truth in Lending Act (TILA); Equal Credit Opportunity Act (ECOA); Fair Credit Reporting Act (FCRA); Electronic Fund Transfer Act (EFTA); Unfair, Deceptive or Abusive Acts or Practices (UDAAP); Gramm-Leach-Bliley Act (GLBA); Fair Debt Collection Practices Act (FDCPA); and, Military Lending Act (MLA), as well as, the adequacy of our compliance management system.

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 incurred in the existing portfolio. The allowance for credit losses is established through a provision for credit losses based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio and current economic conditions. Such evaluation 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 and 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 a 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 the applicable state maximum interest rate, if any, or the maximum interest rate 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 purchases Contracts on an individual basis, although the Company may consider portfolio acquisitions as part of its growth strategy.

The Company utilizes the branch model, which allows for Contract purchasing to be done on the branch level. The Company has detailed underwriting guidelines automated in its loan origination system that 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 internal audit to assure adherence to its underwriting guidelines.

The allowance for credit losses is established through charges to earnings through the provision for credit losses. The allowance for credit losses is maintained at an amount that reduces the net carrying amount of finance receivables for incurred losses.

In analyzing a static pool, the Company considers competition in the market place at the time Contracts are purchased, performance of prior static pools originated by the same 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

Diluted earnings per share decreased 40% to $0.21 as compared to $0.35 for the three months ended December 31, 2015. Net earnings were $1.6 million and $2.7 million for the three months ended December 31, 2016 and 2015, respectively. Revenue decreased 3% to $22.0 million for the three months ended December 31, 2016 as compared to

$22.8 million for the three months ended December 31, 2015.

For the nine months ended December 31, 2016, per share diluted net earnings decreased 33% to $0.83 as compared to $1.24 for the nine months ended December 31, 2015. Net earnings were $6.5 million and $9.7 million for the nine months ended December 31, 2016 and 2015, respectively. Revenue remained relatively flat at $67.6 million for the nine months ended December 31, 2016 as compared to $67.5 million for the nine months ended December 31, 2015.

Our net earnings for the three months ended December 31, 2016 were adversely affected primarily by an increase in the provision for credit losses due to higher charge-offs and past-due accounts along with a reduction in the gross portfolio yield. To a lesser extent, results were favorably impacted by a decrease in operating expenses which was partially offset by a change in the interest rate swaps.

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Our net earnings for the nine months ended December 31, 2016 were adversely affected primarily by an increase in the provision for credit losses due to higher charge-offs and past-due accounts along with a reduction in the gross portfolio yield. Conversely, to a lesser extent, our results were favorably impacted by a decrease in operating expenses.

As previously disclosed and implemented in the beginning of October, the Company made certain changes to our loan operations and collection processes which we believe negatively impacted our charge-offs and past-due accounts. See Future Outlook section for more discussion. As a result of the increased past-due accounts, the Company amended its Line to adjust the availability calculation. See Liquidity and Capital Resources for further discussion.

	Three months ended December 31, (In thousands)		Nine months ended December 31, (In thousands)	
Portfolio Summary	**2016**	**2015**	**2016**	**2015**
Average finance receivables, net of unearned interest (1)	$ 349,916	$ 340,307	$ 345,950	$ 333,006
Average indebtedness (2)	$ 210,745	$ 212,685	$ 209,875	$ 207,072
Interest and fee income on finance receivables	$ 22,044	$ 22,757	$ 67,606	$ 67,469
Interest expense	2,258	2,311	6,745	6,750
Net interest and fee income on finance receivables	$ 19,786	$ 20,446	$ 60,861	$ 60,719
Gross portfolio yield (3)	25.20%	26.75%	26.06%	27.01%
Interest expense as a percentage of average finance receivables, net of unearned interest	2.58%	2.72%	2.60%	2.70%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	10.05%	8.93%	9.24%	7.51%
Net portfolio yield (3)	12.57%	15.10%	14.22%	16.80%
Marketing, salaries, employee benefits, depreciation, administrative and professional fee expenses as a percentage of average finance receivables, net of unearned interest	9.70%	10.19%	10.26%	10.57%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (4)	2.87%	4.91%	3.96%	6.23%
Write-off to liquidation (5)	12.35%	10.31%	11.02%	8.99%
Net charge-off percentage (6)	8.86%	8.19%	8.57%	7.38%

Note: All three-month 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.
(3) Gross portfolio yield represents interest and fee income on finance receivables as a percentage of average finance receivables, net of unearned interest. Net portfolio yield represents interest and fee income on finance receivables minus (a) interest expense and (b) the provision for credit losses as a percentage of average finance receivables, net of unearned interest.
(4) Pre-tax yield represents net portfolio yield minus administrative expenses (marketing, salaries, employee benefits, depreciation, administrative, and professional fees) as a percentage of average finance receivables, net of unearned interest.
(5) Write-off to liquidation percentage is defined as net charge-offs divided by liquidation. Liquidation is defined as beginning gross receivable balance plus current period purchases minus voids and refinances minus ending gross receivable balance.
(6) Net charge-off percentage represents net charge-offs divided by average finance receivables, net of unearned interest, outstanding during the period.

Three months ended December 31, 2016 compared to three months ended December 31, 2015

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, decreased 3.5% to $22.0 million for the three-month period ended December 31, 2016 from 22.8 million for the three-month period ended December 31, 2015. The decrease was primarily due to a decrease in the average dealer discount and a decrease in the average weighted APR, both of which are primarily the result of increased competition for Contracts across all markets.

Average finance receivables, net of unearned interest equaled approximately $349.9 million for the three-month period ended December 31, 2016, an increase of 2.8% from $340.3 million for the corresponding period ended December 31, 2015. The primary reason average finance receivables, net of unearned interest increased was the increase of the receivable base of several existing branches in our younger markets (see Contract Procurement and Loan Origination below). Increases in our average term and average loan amount along with the increase in past-due accounts also contributed to the increase in our finance receivables.

The gross portfolio yield decreased to 25.20% for the three-month period ended December 31, 2016 compared to 26.75% for the three-month period ended December 31, 2015. The gross portfolio yield decreased primarily due to the decrease in the average dealer discount and in the average weighted APR described above, intensified by the increase in average finance receivables, net of unearned interest. To a lesser extent, the gross portfolio yield also decreased due to the increase in past-due accounts. The net portfolio yield decreased to 12.57% for the three-month period ended December 31, 2016 from 15.10% for the corresponding period ended December 31, 2015. The net portfolio yield decreased due to a decrease in the gross portfolio yield and an increase in the provision for credit losses, as described under Analysis of Credit Losses .

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

Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses decreased to approximately $8.5 million for the three-month period ended December 31, 2016 from approximately $8.7 million for the three-month period ended December 31, 2015. The decrease was primarily related to a decrease in average headcount due to the centralization of our loan servicing operations during the three months ended December 31, 2016. The Company decreased average headcount to 305 for the three-month period ended December 31, 2016 from 340 for the three-month period ended December 31, 2015. However, as a result of the Company s subsequent decision to move most of its servicing and collection activity back to the branch offices, as described under Analysis of Credit Losses below, average headcount is expected to rise again compared to the three-month period ended December 31, 2016. Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses as a percentage of finance receivables, net of unearned interest, decreased to 9.70% for the three-month period ended December 31, 2016 from 10.19% for the three-month period ended December 31, 2015.

Interest Expense

Interest expense remained relatively flat at approximately $2.3 million for each of the three-month periods ended December 31, 2016 and December 31, 2015. The following table summarizes the Company s average cost of borrowed funds:

	Three months ended December 31,	
	2016	**2015**
Variable interest under the line of credit facility	**0.77%**	0.39%
Settlements under interest rate swap agreements	**0.09%**	0.17%
Credit spread under the line of credit facility	**3.43%**	3.79%
Average cost of borrowed funds	**4.29%**	4.35%

LIBOR rates have increased (.77% as of December 31, 2016 compared to .43% as of December 31, 2015) which caused a decrease in expense related to our interest rate swap agreements. The increase in LIBOR rates have also caused the credit spread to decrease and the variable interest to increase, but has no net effect on total cost because there is a 1.0% floor on the Line. For further discussions regarding interest rates see Note 5 Line of Credit .

Nine months ended December 31, 2016 compared to nine months December 31, 2015

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income remained relatively flat at approximately $67.6 million for the nine-month period ended December 31, 2016 as compared to $67.5 million for the corresponding period ended December 31, 2015.

Average finance receivables, net of unearned interest equaled approximately $346.0 million for the nine-month period ended December 31, 2016, an increase of 3.9% from $333.0 million for the corresponding period ended December 31, 2015. While our purchasing volume has slowed, due to maintaining our stringent underwriting guidelines, our finance receivables continued growing in our younger markets, including our three newer states (see Contract Procurement and Loan Origination below). Increases in our average term and average loan amount along with the increase in past-due accounts also contributed to the increase in finance receivables.

The gross portfolio yield decreased to 26.06% for the nine-month period ended December 31, 2016 compared to 27.01% for the nine-month period ended December 31, 2015. The gross portfolio yield decreased primarily due to the decrease in the average dealer discount and in the average weighted APR, intensified by the increase in average finance receivables, net of unearned interest. To a lesser extent, the gross portfolio yield also decreased due to the increase in past-due accounts. The net portfolio yield decreased to 14.22% for the nine-month period ended December 31, 2016 from 16.80% for the corresponding period ended December 31, 2015. The net portfolio yield decreased due to a decrease in the gross portfolio yield and an increase in the provision for credit losses, as described under Analysis of Credit Losses .

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

Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses increased to approximately $26.6 million for the nine-month period ended December 31, 2016 from approximately $26.4 million for the corresponding period ended December 31, 2015. The increase was primarily related to an increase in costs associated with maintaining the finance receivable portfolio which was partially offset by a reduction in the average headcount. However, as a result of the Company s subsequent decision to move most of its servicing and collection activity back to the branch offices, as described under Analysis of Credit Losses below, average headcount is expected to rise again compared to the three-month period ended December 31, 2016. Marketing, salaries, employee benefits, depreciation, administrative, and professional fee expenses as a percentage of average finance receivables, net of unearned interest, decreased to 10.26% for the nine-month period ended December 31, 2016 from 10.57% for the nine-month period ended December 31, 2015.

Interest Expense

Interest expense remained relatively flat at $6.7 million for the nine-month period ended December 31, 2016 from $6.8 million for the nine-month period ended December 31, 2015. The following table summarizes the Company s average cost of borrowed funds:

	Nine months ended December 31,	
	2016	**2015**
Variable interest under the line of credit facility	**0.65%**	0.36%

Settlements under interest rate swap agreements	**0.10%**	0.18%
Credit spread under the line of credit facility	**3.53%**	3.81%
Average cost of borrowed funds	**4.28%**	4.35%

LIBOR rates have increased (.77% as of December 31, 2016 compared to .43% as of December 31, 2015) which caused a decrease in expense related to our interest rate swap agreements. The increase in LIBOR rates have also caused the credit spread to decrease and the variable interest to increase, but has no net effect on total cost because there is a 1.0% floor on the Line. For further discussions regarding interest rates see Note 5 Line of Credit .

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Contract Procurement

The Company purchases Contracts in the eighteen 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, 2016 and 2015, less than 1% were for new vehicles.

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

State	As of December 31, 2016 Number of branches	Three months ended December 31, Net Purchases (In thousands) 2016	2015	Nine months ended December 31, Net Purchases (In thousands) 2016	2015
FL	**19**	**$12,950**	$12,002	**$36,527**	$42,533
GA	**6**	**4,195**	3,780	**11,515**	13,745
NC	**6**	**3,740**	3,636	**9,843**	10,785
SC	**2**	**1,213**	1,256	**3,062**	4,769
OH	**7**	**5,100**	5,255	**14,645**	19,076
MI	**2**	**1,725**	2,149	**5,121**	5,634
VA	**2**	**1,126**	989	**3,041**	3,500
IN	**3**	**2,318**	2,107	**6,865**	6,368
KY	**3**	**2,271**	1,896	**6,316**	6,601
MD	**1**	**898**	483	**2,056**	2,047
AL	**2**	**1,138**	932	**3,699**	4,465
TN	**2**	**1,426**	1,439	**3,858**	4,824
IL	**3**	**2,004**	1,651	**5,570**	6,192
MO	**3**	**2,383**	1,672	**5,997**	6,129
KS	**1**	**926**	763	**2,274**	2,183
TX	**2**	**1,578**	1,488	**5,239**	3,211
PA	**1**	**748**		**1,878**	
WI	[a]	**202**	107	**806**	107
Total	**65**	**$45,941**	$41,605	**$128,312**	$142,169

a. Purchases in the state of Wisconsin are currently being acquired and serviced through an Illinois branch.

Contracts	Three months ended December 31, (Purchases in thousands) 2016	2015	Nine months ended December 31, (Purchases in thousands) 2016	2015

Purchases	**$ 45,941**	$ 41,605	**$ 128,312**	$ 142,169
Weighted APR	**21.99%**	22.55%	**22.20%**	22.66%
Average discount	**6.87%**	7.59%	**7.00%**	7.56%
Weighted average term (months)	**57**	56	**57**	56
Average loan	**$ 11,945**	$ 11,346	**$ 11,727**	$ 11,363
Number of Contracts	**3,846**	3,667	**10,942**	12,512

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Loan Origination

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

	Three months ended December 31, (Originations in thousands)		Nine months ended December 31, (Originations in thousands)	
Direct Loans Originated	**2016**	**2015**	**2016**	**2015**
Originations	**$ 2,578**	$ 2,786	**$ 7,109**	$ 7,963
Weighted APR	**25.87%**	25.89%	**26.03%**	25.84%
Weighted average term (months)	**29**	30	**29**	29
Average loan	**$ 3,661**	$ 3,526	**$ 3,563**	$ 3,568
Number of loans	**704**	790	**1,995**	2,232

Analysis of Credit Losses

As of December 31, 2016, the Company had approximately 1,500 active static pools. The average pool upon inception consisted of 62 Contracts with aggregate finance receivables, net of unearned interest, of approximately $708,000.

The provision for credit losses increased to approximately $8.8 million for the three months ended December 31, 2016 from approximately $7.6 million for the three months ended December 31, 2015. This increase is primarily a result of an increase in the net charge-off rate to 8.86% for the three months ended December 31, 2016 from 8.19% for the three months ended December 31, 2015.

The provision for credit losses increased to approximately $24.0 million for the nine months ended December 31, 2016 from approximately $18.8 million for the nine months ended December 31, 2015. This increase is primarily a result of an increase in the net charge-off rate to 8.57% for the nine months ended December 31, 2016 from 7.38% for the nine months ended December 31, 2015. The net charge-off rate increased for both the three and the nine month periods primarily as a result of the increase in competition (causing a higher percentage of acquired loans to be categorized in the lower tiers of the Company s guidelines) as well as the collection challenges described below.

The Company s losses as a percentage of liquidation (see note 5 in the Portfolio Summary table in the Introduction above for the definition of write-off to liquidation) increased to 12.35% for the three months ended December 31, 2016 as compared to 10.31% for the three months ended December 31, 2015. The Company s losses as a percentage of liquidation increased to 11.02% for the nine months ended December 31, 2016 as compared to 8.99% for the nine months ended December 31, 2015. This increase was primarily the result of increased competition in all markets in which the Company presently operates as well as lower resale value at auto auctions. Increased competition continues to drive a higher percentage of loans acquired that are categorized in the lower tiers of the Company s guidelines as well as longer terms and higher advance rates paid to the dealer. Decreased auction proceeds from repossessed vehicles increased the amount of write-offs which, in turn, increased the write-off to liquidation percentage. During the three months ended December 31, 2016 and 2015, auction proceeds from the sale of repossessed vehicles averaged approximately 37% and 40%, respectively, of the related principal balance. During the nine months ended December 31, 2016 and 2015, auction proceeds from the sale of repossessed vehicles averaged approximately 38% and 43%, respectively, of the related principal balance.

Recoveries as a percentage of charge-offs were approximately 6.88% and 9.08% for the three months ended December 31, 2016 and 2015, respectively. Recoveries as a percentage of charge-offs were approximately 7.49% and 10.86% for the nine months ended December 31, 2016 and 2015, respectively. The Company attributes a large portion of this decrease simply to the increase in charge-offs; however, there was also a decrease in the dollars received through our recovery department. Historically, recoveries fluctuate from period to period due to various factors. The increase in competition hinders our ability to collect deficiency balances. Many customers may not be concerned currently about blemished credit histories due to many competitors with less restrictive underwriting guidelines. Approximately every quarter, the Company will aggregate charge-off accounts it deems uncollectible, and sell them to a third-party.

The delinquency percentage for Contracts more than thirty days past due, excluding Chapter 13 bankruptcy accounts, as of December 31, 2016 increased to 14.45% from 7.33% as of December 31, 2015. The delinquency percentage for Direct Loans more than thirty days past due as of December 31, 2016 increased to 4.88% from 2.60% as of December 31, 2015. The increase in delinquency percentage for both Contracts and Direct Loans was driven by the Company s continued portfolio weakness, exacerbated by greater than anticipated difficulties in implementing the centralized collection model, after the Company moved all loan-servicing operations from branch locations to a centralized location within its corporate headquarters in Clearwater.

During the month of November 2016, the Company began soliciting collection assistance from selective branches within its branch network. The Company experienced modest improvement in collections and lower delinquencies and as such broadened its assistance requests to additional branches during the quarter ended December 31, 2016. In early January 2017, the Company elected to move most of its servicing and collection activity back to the branch offices. As of the date of this report, the Company has moved servicing and collection activity for 35 branches, or 54% of its branch network, back to the respective branches. Similarly, the Company anticipates transferring most of the collection activity for its next 10 largest branches to the respective branch locations. Collections for the remaining 20 branch locations are still in the process of being evaluated. Upon the completion of such evaluation, collection activities for these remaining branches may continue centrally or transition back to the individual branches. The Company is also evaluating other means to improve collections.

In addition to the challenges experienced with respect to the changes to its collection model, the Company has continued to see a significant number of competitors with aggressive underwriting in its operating market. See Note 4 - Finance Receivables for changes in allowance for credit losses, credit quality and delinquencies.

The Company considers the following factors to assist in determining the appropriate loss reserve levels: unemployment rates; competition; the number of bankruptcy filings; the results of internal branch audits; consumer sentiment; consumer spending; economic growth (i.e., changes in GDP); the condition of the housing sector; and other leading economic indicators. The Company continues to evaluate reserve levels on a pool-by-pool basis during each reporting period. The longer-term outlook for portfolio performance will depend on overall economic conditions, the unemployment rate, the rational or irrational behavior of the Company s competitors, and the Company s ability to monitor, manage and implement its underwriting and collections philosophy in additional geographic areas as it strives to continue its expansion.

In accordance with our policies and procedures, certain borrowers qualify for, and the Company offers, one-month principal payment deferrals on Contracts and Direct Loans. For the three months ended December 31, 2016 and December 31, 2015 the Company granted deferrals to approximately 11.84% and 6.26%, respectively, of total Contracts and Direct Loans. The increase in the number of deferrals for the three months ended December 31, 2016 is a result of portfolio weakness which was exacerbated by the centralization of collections described above. For the nine months ended December 31, 2016 and December 31, 2015 the Company granted deferrals to approximately 22.85% and 17.78%, respectively, of total Contracts and Direct Loans. The number of deferrals is influenced by portfolio performance, including but not limited to, the unemployment rate, inflation, credit quality of loans purchased, and general economic conditions.

Income Taxes

The provision for income taxes decreased to approximately $1.0 million for the three months ended December 31, 2016 from approximately $1.7 million for the three months ended December 31, 2015. The Company s effective tax rate decreased to 37.93% for the three months ended December 31, 2016 from 38.38% for the three months ended December 31, 2015. The provision for income taxes decreased to approximately $4.0 million for the nine months ended December 31, 2016 from approximately $6.0 million for the nine months ended December 31, 2015. The Company s effective tax rate decreased to 38.01% for the nine months ended December 31, 2016 from 38.42% for the nine months ended December 31, 2015.

Liquidity and Capital Resources

The Company s cash flows are summarized as follows:

	Nine months ended December 31, (In thousands)	
	2016	**2015**
Cash provided by (used in):		
Operating activities	**$ 23,860**	$ 17,392
Investing activities (primarily purchase of Contracts)	**(25,574)**	(31,305)
Financing activities	**3,529**	13,531
Net increase (decrease) in cash	**$ 1,815**	$ (382)

The Company s primary use of working capital during the nine months ended December 31, 2016, was the funding of the purchase of Contracts which are financed substantially through cash from principal payments received and cash from operations. The Line is secured by all of the assets of the Company and has a maturity date of January 31, 2018. The Company may borrow up to $225.0 million under the Line. Prior to December 30, 2016, borrowings under the Line were under various LIBOR pricing options plus 300 basis points with a 1% floor on LIBOR. Effective December 30, 2016 the Company entered into an amendment to adjust its availability calculation which temporarily increased pricing of the Line to 350 basis point above 30 day LIBOR with the 1% floor on LIBOR through June 30, 2017. As of December 31, 2016, the amount outstanding under the Line was $214.3 million, and the amount available under the Line was approximately $10.7 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 increased by $3.3 million during the nine months ended December 31, 2016 compared to the prior year period. This increase is principally related to the fact that cash needed to fund the purchase of new Contracts exceeded cash received from operations. The amount of debt the Company incurs from time to time under the Line depends on the Company s need for cash and ability to borrow under the terms of the Line. The Company believes that borrowings available under the Line as well as cash flow from operations will be sufficient to meet its short-term funding needs. The borrowings available under the Line are calculated every month based on individual loan criteria as defined in the credit agreement; therefore, no assurances can be given that the Company will maintain sufficient availability in the long term. The Line requires compliance with certain debt covenants including financial ratios, asset quality and other performance tests. The Company is in compliance with all of its debt covenants as of December 31, 2016.

Contractual Obligations

The following table summarizes the Company s material obligations as of December 31, 2016.

	Payments Due by Period (In thousands)				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Operating leases	$ 4,845	$ 2,071	$ 2,570	$ 204	$
Line of credit1	214,340		214,340		
Interest on Line1	10,474	9,710	764		
Total	$ 229,659	$ 11,781	$ 217,674	$ 204	$

1. The Company s Line matures on January 30, 2018. Effective December 30, 2016, the Company entered into a temporary agreement that increases the effective interest rate by 50 bps through June 30, 2017. Interest on outstanding borrowings under the Line as of December 31, 2016, is based on an effective interest rate of 4.53% which includes the estimated effect of the interest rate swap agreements settlements and the temporary agreement through the maturity date. The effective interest rate used in the above table does not contemplate the possibility of entering into interest rate swap agreements in the future.

Future Outlook

The Company currently (as of February 9, 2017) operates a total of 65 branch locations in eighteen states (see Contract Procurement). The Company continues to evaluate potential new markets while maintaining its existing markets. The Company may choose to close or consolidate certain existing branches if they are unable to acquire profitable Contracts that meet Company expectations. As a result of continued intense competition, the Company has been evaluating the long-term sustainability of its current branch-based model. As previously disclosed, in the beginning of October, the Company moved all loan-servicing operations from branch locations to a centralized location within its corporate headquarters in Clearwater. The Company s continued portfolio weakness was exacerbated by greater than anticipated difficulties in implementing the centralized collection model, as described in greater detail under Analysis of Credit Losses above. While the Company has transferred, and anticipates transferring additional, collection activity back to the respective branch locations, the collections for 20 branch locations are still in the process of being evaluated. Upon the completion of such evaluation, collection activities for these remaining branches may continue centrally or transition back to the individual branches. The Company is also evaluating other means to improve collections.

We continue to evaluate the various markets in which we operate; however, we do not expect any significant changes to the number of branches or other operations during our fourth quarter ending March 31, 2017. The Company continues to evaluate various strategies in an effort to improve its portfolio performance and reduce its operating expenses, although no assurances can be given that it will be successful in identifying and implementing such strategies.

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. The Company does not use interest rate swap agreements for speculative purposes.

As of December 31, 2016, $164.3 million, or approximately 76.7% of our total debt, was subject to floating interest rates; however, due to a 1% floor on such interest rates, these rates are effectively fixed until the variable rates exceed this threshold. As a result, a hypothetical increase in the variable interest rates of 1% or 100 basis points ([which would result in the variable rates being] 1.77% as of December 31, 2016) applicable to this floating rate debt would result in an annual after-tax increase of interest expense of approximately $709,000.

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 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 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 control over financial reporting. 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 1. LEGAL PROCEEDINGS

The Company currently is not a party to any pending legal proceedings other than ordinary routine litigation incidental to its business, none of which, if decided adversely to the Company, would, in the opinion of management, have a material adverse effect on the Company s financial condition or results of operations.

ITEM 1A. RISK FACTORS

In addition to the risk factors below and 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, 2016, which could materially affect our business, financial condition or future results. The risks described in this Form 10-Q and 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 09, 2017	/s/ Ralph T. Finkenbrink Ralph T. Finkenbrink Chairman of the Board, President, Chief Executive Officer and Director
Date: February 09, 2017	/s/ Katie L. MacGillivary Katie L. MacGillivary Vice President and Chief Financial Officer

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EXHIBIT INDEX

Exhibit No.	Description
10.1[1]	Amendment No. 5, effective December 30, 2017, to Second Amended and Restated Loan and Security Agreement, dated as of January 12, 2010, by and among Nicholas Financial Inc., a Florida corporation, Bank of America, N.A., as agent, and each of the Lenders parties thereto
10.8	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements
31.1	Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Vice President and Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1[2]	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. § 1350
32.2[2]	Certification of the Chief Financial Officer Pursuant to 18 U.S.C. § 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

1 Incorporated by reference to Exhibit 10.1 to the Form 8-K filed on January 11, 2017 (File No. 000-26680).
2 This certification accompanies the Quarterly Report on Form 10-Q and is not filed as part of it.