NICHOLAS FINANCIAL INC
Form 10-Q
November 14, 2018
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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 September 30, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _______ TO _______.
Commission file number: 0-26680

NICHOLAS FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

British Columbia, Canada	**8736-3354**
(State or Other Jurisdiction of	**(I.R.S. Employer**

Incorporation or Organization)	**Identification No.)**

2454 McMullen Booth Road, Building C

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

(727) 726-0763

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically every Interactive Data File required to be submitted 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 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, smaller reporting company and emerging growth company in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of November 8, 2018, 12,619,744 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 7,905,940 shares were entitled to vote).

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands)

	September 30, 2018 (Unaudited)	March 31, 2018
Assets		
Cash	**$ 2,787**	$ 2,626
Finance receivables, net	**236,241**	266,573
Assets held for resale	**2,461**	2,117
Income taxes receivable	**1,702**	1,505
Prepaid expenses and other assets	**1,080**	906
Property and equipment, net	**674**	843
Deferred income taxes	**5,445**	6,289
Total assets	**$ 250,390**	$ 280,859
Liabilities and shareholders equity		
Line of credit	**$ 134,200**	$ 165,750
Drafts payable	**1,421**	1,672
Accounts payable and accrued expenses	**4,305**	5,000
Total liabilities	**$ 139,926**	$ 172,422
Shareholders equity		
Preferred stock, no par: 5,000 shares authorized; none issued		
Common stock, no par: 50,000 shares authorized; 12,618 and 12,609 shares issued, respectively; and 7,904 and 7,895 shares outstanding, respectively	**$ 34,591**	$ 34,564
Treasury stock: 4,714 common shares, at cost	**(70,459)**	(70,459)
Retained earnings	**146,332**	144,332
Total shareholders equity	**110,464**	108,437
Total liabilities and shareholders equity	**$ 250,390**	$ 280,859

See Notes to the Consolidated Financial Statements.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)

	Three months ended September 30,		Six months ended September 30,	
	2018	2017	**2018**	2017
Interest and fee income on finance receivables	**$ 19,404**	$ 21,338	**$ 38,163**	$ 43,536
Expenses:				
Marketing	**737**	353	**1,104**	744
Salaries and employee benefits	**4,341**	4,847	**9,607**	10,009
Administrative	**2,792**	2,858	**5,857**	5,853
Provision for credit losses	**8,374**	10,146	**13,801**	19,898
Depreciation	**96**	119	**199**	240
Interest expense	**2,386**	2,443	**4,926**	4,898
Change in fair value of interest rate swap agreements		8		17
	18,726	20,774	**35,494**	41,659
Operating income before income taxes	**678**	564	**2,669**	1,877
Income tax expense	**96**	220	**669**	720
Net income	**$ 582**	$ 344	**$ 2,000**	$ 1,157
Earnings per share:				
Basic	**$ 0.07**	$ 0.04	**$ 0.25**	$ 0.15
Diluted	**$ 0.07**	$ 0.04	**$ 0.25**	$ 0.15

See Notes to the Consolidated Financial Statements.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Six months ended September 30, 2018	Six months ended September 30, 2017
Cash flows from operating activities		
Net income	**$ 2,000**	$ 1,157
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	**199**	240
Gain on sale of property and equipment		(15)
Provision for credit losses	**13,801**	19,898
Amortization of dealer discounts	**(5,904)**	(5,942)
Amortization of commission for products	**(1,040)**	(841)
Deferred income taxes	**844**	(1,045)
Share-based compensation	**16**	130
Change in fair value of interest rate swap agreements		17
Changes in operating assets and liabilities:		
Accrued interest receivable	**100**	(50)
Prepaid expenses and other assets	**27**	(37)
Accounts payable and accrued expenses	**(695)**	(555)
Income taxes receivable	**(197)**	91
Net cash provided by operating activities	**9,151**	13,048
Cash flows from investing activities		
Purchase and origination of finance receivables	**(39,961)**	(52,943)
Principal payments received	**63,335**	65,942
Increase in assets held for resale	**(344)**	(159)
Purchase of property and equipment	**(30)**	(139)
Proceeds from sale of property and equipment		16
Net cash provided by investing activities	**23,000**	12,717
Cash flows from financing activities		
Decrease on line of credit	**(31,550)**	(25,000)
Change in drafts payable	**(251)**	(286)
Payment of loan origination fees	**(200)**	
Proceeds from exercise of stock options	**11**	338

Net cash used in financing activities	**(31,990)**	(24,948)
Net increase in cash	**161**	817
Cash, beginning of period	**2,626**	2,855
Cash, end of period	**$ 2,787**	$ 3,672

See Notes to the Consolidated Financial Statements.

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1. Basis of Presentation

The accompanying consolidated balance sheet as of March 31, 2018, 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, with the instructions to Form 10-Q pursuant to the Securities and Exchange Act of 1934, as amended, and with Article 8 of Regulation S-X thereunder. 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, 2019. 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, 2018 as filed with the Securities and Exchange Commission on June 27, 2018. The March 31, 2018 consolidated balance sheet included herein has been derived from the March 31, 2018 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 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, 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 weighted average dealer discount associated with new volume for the three months ended September 30, 2018 and 2017 was 8.42% and 7.27%, respectively in relation to the total amount financed. The weighted average dealer discount associated with new volume for the six months ended September 30, 2018 and 2017 was 8.36% and 7.41%, respectively.

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.

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3. Earnings Per Share

The Company has granted stock compensation awards with nonforfeitable dividend rights which are considered participating securities. Earnings per share is calculated using the two-class method, as such awards are more dilutive under this method than the treasury stock 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 September 30, (In thousands, except per share amounts)		Six months ended September 30, (In thousands, except per share amounts)	
	2018	2017	**2018**	2017
Numerator:				
Net income	**$ 582**	$ 344	**$ 2,000**	$ 1,157
Less: Allocation of earnings to participating securities	**(5)**	(4)	**(15)**	(14)
Net income allocated to common stock	**$ 577**	$ 340	**$ 1,985**	$ 1,143
Basic earnings per share computation:				
Net income allocated to common stock	**$ 577**	$ 340	**$ 1,985**	$ 1,143
Weighted average common shares outstanding, including shares considered participating securities	**7,774**	7,847	**7,859**	7,834
Less: Weighted average participating securities outstanding	**(61)**	(106)	**(65)**	(98)
Weighted average shares of common stock	**7,713**	7,741	**7,794**	7,736
Basic earnings per share	**$ 0.07**	$ 0.04	**$ 0.25**	$ 0.15
Diluted earnings per share computation:				
Net income allocated to common stock	**$ 577**	$ 340	**$ 1,985**	$ 1,143
Undistributed earnings re-allocated to participating securities				
Numerator for diluted earnings per share	**$ 577**	**$ 340**	**$ 1,985**	**$ 1,143**
Weighted average common shares outstanding for basic earnings per share	**7,713**	7,741	**7,794**	7,736
Incremental shares from stock options	**6**	45	**6**	48
Weighted average shares and dilutive potential common shares	**7,719**	7,786	**7,800**	7,784

Diluted earnings per share	**$ 0.07**	$ 0.04	**$ 0.25**	$ 0.15

Diluted earnings per share do not include the effect of certain stock options as their impact would be anti-dilutive. For the three months ended September 30, 2018 and 2017, potential shares of common stock from stock options totaling 79,600 and 154,565, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive. For the six months ended September 30, 2018 and 2017, potential shares of common stock from stock options totaling 79,600 and 149,781, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

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4. Finance Receivables

Finance Receivables Portfolio

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

	(In thousands)	
	September 30, 2018	**March 31, 2018**
Finance receivables	**$ 267,236**	$ 301,155
Accrued interest receivable	**2,542**	2,642
Unearned dealer discounts	**(11,352)**	(13,655)
Unearned insurance and fee commissions	**(3,009)**	(3,303)
Finance receivables, net of unearned	**255,417**	286,839
Allowance for credit losses	**(19,176)**	(20,266)
Finance receivables, net	**$ 236,241**	$ 266,573

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

	As of September 30,	
Contract Portfolio	**2018**	**2017**
Weighted APR	**22.37%**	22.24%
Weighted average discount	**7.23%**	7.32%
Weighted average term (months)	**54**	57
Number of active contracts	**30,548**	34,935

	As of September 30,	
Direct Loan Portfolio	**2018**	**2017**
Weighted APR	**25.14%**	25.23%
Weighted average term (months)	**32**	33
Number of active contracts	**2,458**	2,721

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 predominantly for used vehicles. As of September 30, 2018, the average model year of vehicles collateralizing the portfolio was a 2010 vehicle.

Direct Loans are typically for amounts ranging from $500 to $11,000 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 better credit risk than typical Contracts due to the customer s prior payment history with the Company; however, the underlying collateral is less valuable. In deciding whether 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 the Direct Loans made by the Company to date have been made to current or former customers, the payment history of the borrower is a significant factor in making the loan decision. As of September 30, 2018, loans made by the Company pursuant to its Direct Loan program constituted approximately 3% 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 primarily by current economic conditions and credit loss trends over several reporting periods which are utilized in estimating future losses and overall portfolio performance.

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

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Allowance for Credit Losses

The following table sets forth a reconciliation of the changes in the allowance for credit losses on Contracts and Direct Loans for the three months ended September 30, 2018 and 2017:

	Three months ended September 30, 2018		
	Contracts	Direct Loans	Consolidated
Balance at beginning of period	$ 18,116	$ 949	$ 19,065
Provision (benefit) for credit losses	8,684	(310)	8,374
Charge-offs	(8,578)	(164)	(8,742)
Recoveries	470	9	479
Balance at September 30, 2018	**$ 18,692**	**$ 484**	**$ 19,176**

	Three months ended September 30, 2017		
	Contracts	Direct Loans	Consolidated
Balance at beginning of period	$ 18,379	$ 774	$ 19,153
Provision for credit losses	10,022	124	10,146
Charge-offs	(8,936)	(122)	(9,058)
Recoveries	502	6	508
Balance at September 30, 2017	**$ 19,967**	**$ 782**	**$ 20,749**

The following table sets forth a reconciliation of the changes in the allowance for credit losses on Contracts and Direct Loans for the six months ended September 30, 2018 and 2017:

	Six months ended September 30, 2018		
	Contracts	Direct Loans	Consolidated
Balance at beginning of period	$ 19,433	$ 833	$ 20,266
Provision (benefit) for credit losses	13,912	(111)	13,801
Charge-offs	(15,629)	(254)	(15,883)
Recoveries	976	16	992
Balance at September 30, 2018	$ 18,692	$ 484	$ 19,176

	Six months ended September 30, 2017		
	Contracts	Direct Loans	Consolidated
Balance at beginning of period	$ 16,885	$ 773	$ 17,658

Provision for credit losses	19,680	218	19,898
Charge-offs	(17,628)	(223)	(17,851)
Recoveries	1,030	14	1,044
Balance at September 30, 2017	**$ 19,967**	**$ 782**	**$ 20,749**

During the first quarter of the fiscal year ended March 31, 2019, the Company began using the trailing six-month charge-offs, annualized, to calculate the allowance for credit losses. This change was made to reflect changes in the Company s lending policies and underwriting standards, which were a result of the Company changing its business strategies. The Company changed its focus to financing primary transportation to and from work for the subprime borrower. This change resulted in higher yielding loans, smaller amounts financed, and shorter monthly terms.

During the second quarter of the fiscal year ended March 31, 2019 the Company calculated the charge-off percentage for Contracts and calculated the charge-off percentage for Direct Loans. Prior to that, the charge-off percentage combined the Contracts and Direct Loans. This resulted in an approximately $376,000 reduction in the Direct Loan provision for credit losses and an approximately $758,000 increase in the Contracts provision for credit losses.

In addition, the Company takes into consideration the composition of the portfolio, current economic conditions, the estimated net realizable value of the underlying collateral, historical loan loss experience, delinquency, non-performing assets, and bankrupt accounts when determining management s estimate of probable credit losses and adequacy of the allowance for credit losses. If the allowance for credit losses is determined to be inadequate, then an additional charge to the provision would be recorded to maintain adequate reserves based on management s evaluation of the risk inherent in the loan portfolio.

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Prior to June 30, 2018, the Company calculated the allowance for credit losses by reference to static pools, which each pool consisted of Contracts purchased during a three-month period for each branch location as management considers these pools to have similar risk characteristics and were considered smaller-balance homogenous loans. The Company analyzed each consolidated static pool at specific points in time to estimate losses that were probable of being incurred as of the reporting date. The Company maintained historical write-off information for over 10 years with respect to every consolidated static pool and segregated such static pool by liquidation, thereby creating snapshots or buckets of each pool s historical write-off-to liquidation ratio at five different points in each vintage pool s liquidation cycle. These snapshots were then used to assist in determining the allowance for credit losses. The five snapshots were tracked at liquidation levels of 20%, 40%, 60%, 80% and 100%.

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

	(In thousands)			
	September 30, 2018		**September 30, 2017**	
	Contracts	Direct Loans	Contracts	Direct Loans
Performing accounts	**$ 245,603**	**$ 7,257**	$ 293,673	7,953
Non-performing accounts	**10,492**	**208**	17,459	216
Total	**$ 256,095**	**$ 7,465**	$ 311,132	8,169
Chapter 13 bankruptcy accounts	**3,582**	**94**	3,901	35
Finance receivables, gross contract	**$ 259,677**	**$ 7,559**	$ 315,033	8,204

A performing account is defined as an account that is less than 61 days past due. The Company defines an automobile contract as delinquent when more than 25% of a payment contractually due by a certain date has not been paid by the immediately following due date, which date may have been extended within limits specified in the servicing agreements or as a result of a deferral. The period of delinquency is based on the number of days payments are contractually past due, as extended where applicable.

In certain circumstances, the Company will grant obligors one-month payment extensions. The only modification of terms in those circumstances is to advance the obligor s next due date by one month and extend the maturity date of the receivable. There are no other concessions, such as a reduction in interest rate, or forgiveness of principal or of accrued interest. Accordingly, the Company considers such extensions to be insignificant delays in payments rather than troubled debt restructurings.

A non-performing account is defined as an account that is contractually delinquent for 61 days or more or is a Chapter 13 bankruptcy account, and on which the accrual of interest income is suspended. As of September 1, 2016, an account is written off when an account is 180 days contractually delinquent, which is consistent with practices within the subprime auto financing industry. Upon notification of a bankruptcy, an account is 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, whether to begin repossession proceedings or to allow the customer to begin making regularly scheduled payments. The Company does consider Chapter 13 bankruptcy accounts to be troubled debt restructurings and included in the Company s allowance for credit losses is a specific reserve of approximately

$771,000 and $0 for these accounts as of September 30, 2018 and September 30, 2017, respectively.

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

	(In thousands, except percentages)					
Contracts	**Balance Outstanding**	**31 60 days**	**61 90 days**	**91 120 days**	**Over 120**	**Total**
September 30, 2018	**$ 256,095**	**$ 18,322**	**$ 6,341**	**$ 2,181**	**$ 1,970**	**$ 28,814**
		7.15%	**2.48%**	**0.85%**	**0.77%**	**11.25%**
September 30, 2017	$ 311,132	$ 18,330	$ 8,768	$ 5,067	$ 3,624	$ 35,789
		5.89%	2.82%	1.63%	1.16%	11.50%

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Direct Loans	Balance Outstanding	31 60 days	61 90 days	91 120 days	Over 120	Total
September 30, 2018	**$ 7,465**	**$ 171**	**$ 113**	**$ 27**	**$ 68**	**$ 379**
		2.29%	**1.51%**	**0.36%**	**0.91%**	**5.08%**
September 30, 2017	$ 8,169	$ 216	$ 50	$ 54	$ 112	$ 432
		2.64%	0.61%	0.66%	1.37%	5.29%

5. Line of Credit

The Company had a line of credit facility (the Line of Credit or the Line) up to $225 million during fiscal year 2018. On March 30, 2018, the Company executed Amendment 8, a one-year renewal extending the maturity date to March 30, 2019 and reducing the Line of Credit facility to $200 million and changing the minimum interest coverage ratio from a quarterly to monthly test. The pricing of the Line of Credit remained at 400 basis points above 30-day LIBOR, with a 1% floor on LIBOR and the beneficial ownership limit remained at 30%.

Pledged as collateral for this Line of Credit are all the assets of the Company.

The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. The Company s operating results over the past two years provide indicators that the Company may not be able to continue to comply with certain of the required financial ratios, covenants and financial tests prior to the maturity date of the Line of Credit in the absence of an amendment to the corresponding credit agreement or waiver. On November 2, 2018, the Company entered into a Waiver and Amendment No. 9 (Amendment No. 9) to the Second Amended and Restated Loan and Security Agreement governing the Line of Credit. Among other things, Amendment 9 waived compliance with the minimum interest coverage ratio and minimum loss reserve requirements for the measurement period ending August 31, 2018. With this amendment, the Company was in compliance with all debt covenants as of September 30, 2018. See Note 11 Subsequent Events for further discussion of Amendment No. 9. Failure to meet any financial ratios, covenants or financial tests could result in an event of default under the credit facility. If an event of default occurs under the credit facility, the Company s lenders could increase the Company s borrowing costs, restrict the ability to obtain additional borrowings under the facility, accelerate all amounts outstanding under the facility, or enforce their interest against collateral pledged under the facility.

There are no assurances that the lenders will approve the renewal or extension, or, assuming that they will approve it, that the Line of Credit will not be on terms less favorable than the current agreement. In the event, the Company obtains information that the existing lenders do not intend to extend the relationship, the Company will seek alternative financing. The Company believes it is probable that it will be able to obtain financing from either its existing lenders or from other sources; however, it cannot provide any assurances that it will be successful in replacing the Line of Credit on reasonable terms or at all.

6. Interest Rate Swap Agreements

From time to time, the Company has utilized 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 September 30, 2018 and 2017, the Company had no interest rate swaps in place.

On June 13, 2017 an interest rate swap agreement with an effective date of June 13, 2012, a notional amount of $25.0 million, and a fixed rate of interest of 1.00% expired.

On July 30, 2017 an interest rate swap agreement with an effective date of July 30, 2012, a notional amount of $25.0 million, and a fixed rate of interest of 0.87% expired.

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The locations and amounts of loss and gain in income are as follows:

	Three months ended September 30, 2017 (In thousands)	Six months ended September 30, 2017 (In thousands)
Periodic change in fair value of interest rate swap agreements	$ 8	$ 17
Periodic settlement differentials included in interest expense	8	18
Loss recognized in income	$ 16	$ 35

Net realized losses and gains 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 September 30, 2017	**Six months ended September 30, 2017**
Variable rate received	**1.22%**	**1.05%**
Fixed rate paid	**0.87%**	**0.91%**

7. Income Taxes

The provision for income taxes decreased to approximately $0.1 million for the three months ended September 30, 2018 from approximately $0.2 million for the three months ended September 30, 2017. The Company s effective tax rate decreased to 14.2% for the three months ended September 30, 2018 from 39.0% for the three months ended September 30, 2017. The provision for income taxes remained approximately $0.7 million for the six months ended September 30, 2018 and the six months ended September 30, 2017. The Company s effective tax rate decreased to 25.1% for the six months ended September 30, 2018 from 38.4% for the six months ended September 30, 2017. The changes in the effective rates were attributed to the Tax Cuts and Jobs Act.

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.

Financial Instruments Not Measured at Fair Value

The Company s financial instruments consist of cash, finance receivables and the Line of Credit. 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. Beginning in December 2017, the maximum initial term of a Contract was reduced to 60 months. The initial terms of the Direct Loans generally range from 12 to 60 months. 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 be expected to contain pricing that approximates the Company s current Line of Credit. Based on these market conditions, the fair value of the Line of Credit as of September 30, 2018 was estimated to be equal to the book value. The interest rate for the Line of Credit is a variable rate based on LIBOR pricing options.

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	(In thousands)				
	Fair Value Measurement Using				
Description	Level 1	Level 2	Level 3	Fair Value	Carrying Value
Cash:					
September 30, 2018	**$ 2,787**	**$**	**$**	**$ 2,787**	**$ 2,787**
March 31, 2018	$ 2,626	$	$	$ 2,626	$ 2,626
Finance receivables:					
September 30, 2018	**$**	**$**	**$ 236,241**	**$ 236,241**	**$ 236,241**
March 31, 2018	$	$	$ 267,401	$ 267,401	$ 266,573
Line of credit:					
September 30, 2018	**$**	**$ 134,200**	**$**	**$ 134,200**	**$ 134,200**
March 31, 2018	$	$ 165,750	$	$ 165,750	$ 165,750

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 September 30, 2018 and March 31, 2018.

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. Summary of Significant Accounting Policies

Reclassifications

The Company made certain reclassifications to finance receivables, as a result of which it no longer reports a gross receivable and unearned interest balance. Therefore, the prior fiscal year balance sheet reflects a reclassification, to net the gross receivable and the unearned interest balance. The Company also reclassed the deferred revenue from a liability to net finance receivables, net of unearned discounts and insurance commissions. Net income and shareholders equity were not changed.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) . The ASU outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The guidance also requires disclosures regarding the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Entities have the option to apply the new guidance under a retrospective approach to each prior reporting period presented or a modified retrospective approach with the cumulative effect of initially applying the new guidance recognized at the date of initial application within the Statement of Consolidated Financial Position. 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 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. On April 1, 2018, the Company adopted the new guidance utilizing the modified retrospective transition method. The adoption of this guidance did not have a material impact on the Company s consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation Stock Compensation (Topic 718). The guidance provides clarification on when modification accounting should be used for changes to the terms or conditions of a share-based payment award. This guidance is effective for fiscal years beginning after December 15, 2017 and for interim periods within those fiscal years, with early adoption permitted. The Company adopted the guidance on April 1, 2018, and it believes the adoption of this guidance did not have a material impact on its Consolidated Financial Statements and related disclosures.

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In January 2017, the FASB issued ASU 2017-01, Business Combinations (Topic 805). The guidance clarifies the definition of a business, which assists entities when evaluating whether transactions should be accounted for as acquisitions of businesses or assets. This guidance is effective on a prospective basis for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company adopted the guidance on April 1, 2018 and it believes the adoption of this guidance did not have a material impact on its Consolidated Financial Statements.

In August 2016, the 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. The Company adopted the guidance on April 1, 2018 and does not believe ASU 2016-15 had a material impact on its Consolidated Financial Statements.

Recent Accounting Pronouncements

In February 2018, the FASB issued Accounting Standards Update (ASU) No. 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income was issued to address a narrow-scope financial reporting issue that arose as a consequence of the change in the tax law. On December 22, 2017, the U.S. federal government enacted a tax bill, H.R.1, An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (Tax Cuts and Jobs Act of 2017). The ASU No. 2018-02 permits a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate income tax rate. The amount of the reclassification would be the difference between the historical corporate income tax rate of 35 percent and the newly enacted 21 percent corporate income tax rate. The ASU No. 2018-02 is effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years with early adoption permitted, including adoption in any interim period, for (i) public business entities for reporting periods for which financial statements have not yet been issued and (ii) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The adoption of this guidance will not impact the company s Consolidated Financial Statements or disclosures.

In August 2017, the Financial Accounting Standards Board (FASB) issued ASU 2017-12 Derivatives and Hedging (Topic 815). The guidance is intended to better align an entity s risk management activities and financial reporting for hedging relationships. This guidance is effective for fiscal years beginning after December 15, 2018 and for interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating impact of the adoption of this guidance on its Consolidated Financial Statements and related disclosures.

In June 2016, the FASB issued the ASU 2016-13 Financial Instruments Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. Among other things, the amendments in this ASU require the measurement of all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to reflect the full amount of expected credit losses. 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 and is collecting and analyzing data that will be needed to produce historical inputs into any models created as a result of adopting this ASU. At this time, we believe the adoption of this ASU will likely have a material effect and is expected to increase the overall allowance for credit losses.

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. Upon adoption, the Company will add the impact of the full operating lease terms, using the present value of future minimum lease payments to the balance sheet. The Company will continue to evaluate the impact of the adoption of this ASU on the 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.

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11. Subsequent Event

On November 2, 2018, the Company entered into an amendment to its existing loan and security agreement governing the terms and conditions of its credit facility.

requires the Company to maintain availability of at least five percent (5%) of the borrowing base; and

waives compliance with the minimum interest coverage ratio and minimum loss reserve requirements for the measurement period ending August 31, 2018; and

modifies the minimum interest coverage ratio requirement to be 0.00 to 1.0 for the measurement period ending September 30, 2018, 0.80 to 1.00 for the measurement period ending October 31, 2018, and 1.0 to 1.0 for the measurement period ending November 30, 2018 and thereafter.

The interest coverage ratio is calculated as of each month end for the three-month period then ended as the ratio of (A) the Company s adjusted net earnings plus interest expense and provision for income tax for the applicable period to (B) the Company s interest expenses for such period. The minimum loss reserve amount is calculated as of each month for the tree-month period then ended as (A) four times the net charge-offs divided by (B) the net balances due under all contracts divided by three. The interest rates for borrowings under the credit facility remain at base rate plus 3.0% or LIBOR plus 4.0%.

The Company s obligations under the loan and security agreement are secured by substantially all of the operating assets of the Company. The loan and security agreement contains other events of default and requires the Company to comply with certain other financial ratios and covenants and to satisfy specified financial tests, including maintenance of asset quality and portfolio performance tests. Failure to meet any required financial ratios, covenants or financial tests could result in an event of default under the loan and security agreement. If an event of default occurs, the Company s lenders could increase borrowing costs, restrict the Company s ability to obtain additional borrowings under the facility, accelerate all amounts outstanding under the facility, or enforce their interest against collateral pledged under the facility.

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

Forward-Looking Information

This Quarterly Report on Form 10-Q contains various forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Such statements are based on management s current beliefs and assumptions, as well as information currently available to management. When used in this document, the words anticipate , estimate , expect , will , may , plan, believe , intend and similar exp intended to identify forward-looking statements. Although Nicholas Financial, Inc., including its subsidiaries (collectively, the Company, we, us, or our) believes that the expectations reflected or implied in such forward-look 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, including but not limited to the risk factors discussed under Item 1A Risk Factors in our Annual Report on Form 10-K, and our other filings made with the U.S. Securities and Exchange Commission (SEC). 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 cause actual results to differ materially from those projected in forward-looking statements include the availability of capital (including the ability to access bank financing), recently enacted, proposed or future legislation and the manner in which it is implemented, including the effect of changes in tax law, such as the effect of the Tax Cuts and Jobs Act, fluctuations in the economy, the degree and nature of competition and its effects on the Company s financial results, fluctuations in interest rates, the effectiveness of the Company s internal control over financial reporting and disclosure controls and procedures, demand for consumer financing in the markets served by the Company, the Company s products and services, increases in the default rates experienced on Contracts, adverse regulatory changes in the Company s existing and future markets, the Company s intentions regarding strategic alternatives, 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 recruit and retain qualified employees. All forward-looking statements included in this Quarterly Report are based on information available to the Company as of the date of filing of this Quarterly Report, and the Company assumes no obligation to update any such forward-looking statement.

Litigation and Legal Matters