

NICHOLAS FINANCIAL INC
Form 10-Q
August 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 June 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
(State or Other Jurisdiction of

8736-3354
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

2454 McMullen Booth Road, Building C

Clearwater, Florida
(Address of Principal Executive Offices)

33759
(Zip Code)

(727) 726-0763

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the Registrant 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, 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 August 1, 2018, 12,622,926 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 7,909,122 shares were entitled to vote).

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NICHOLAS FINANCIAL, INC.

FORM 10-Q

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Balance Sheets

(In thousands)

	June 30, 2018 (Unaudited)	March 31, 2018
Assets		
Cash	\$ 4,981	\$ 2,626
Finance receivables, net	256,590	269,876
Assets held for resale	2,187	2,117
Income taxes receivable	1,256	1,505
Prepaid expenses and other assets	1,175	906
Property and equipment, net	755	843
Deferred income taxes	5,966	6,289
Total assets	\$ 272,910	\$ 284,162
Liabilities and shareholders equity		
Line of credit	\$ 151,000	\$ 165,750
Drafts payable	3,164	1,672
Accounts payable and accrued expenses	5,505	5,000
Deferred revenues	3,253	3,303
Total liabilities	162,922	175,725
Shareholders equity		
Preferred stock, no par: 5,000 shares authorized; none issued		
Common stock, no par: 50,000 shares authorized; 12,623 and 12,609 shares issued, respectively; and 7,909 and 7,895 shares outstanding, respectively	34,695	34,564
Treasury stock: 4,714 common shares, at cost	(70,459)	(70,459)
Retained earnings	145,752	144,332
Total shareholders equity	109,988	108,437
Total liabilities and shareholders equity	\$ 272,910	\$ 284,162

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Income

(Unaudited)

(In thousands, except per share amounts)

	Three months ended June 30,	
	2018	2017
Interest and fee income on finance receivables	\$ 18,759	\$ 22,198
Expenses:		
Marketing	367	391
Salaries and employee benefits	5,266	5,162
Administrative	3,065	2,995
Provision for credit losses	5,426	9,752
Depreciation	103	121
Interest expense	2,540	2,455
Change in fair value of interest rate swap agreements		9
	16,767	20,885
Operating income before income taxes	1,992	1,313
Income tax expense	572	500
Net income	\$ 1,420	\$ 813
Earnings per share:		
Basic	\$ 0.18	\$ 0.10
Diluted	\$ 0.18	\$ 0.10

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Three months ended	
	June 30,	
	2018	2017
Cash flows from operating activities		
Net income	\$ 1,420	\$ 813
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	103	121
Gain on sale of property and equipment		(8)
Provision for credit losses	5,426	9,752
Amortization of dealer discounts	(2,247)	(3,043)
Amortization of commission for products	(538)	(433)
Deferred income taxes	323	(620)
Share-based compensation	60	124
Excess tax (deficiency) benefit from share-based compensation		(16)
Change in fair value of interest rate swap agreements		9
Changes in operating assets and liabilities:		
Accrued interest receivable	33	211
Prepaid expenses and other assets	(69)	(102)
Accounts payable and accrued expenses	505	(953)
Income taxes payable and receivable	249	1,125
Deferred revenues	(50)	(262)
Net cash provided by operating activities	5,215	6,718
Cash flows from investing activities		
Purchase and origination of finance receivables	(22,173)	(25,056)
Principal payments received	32,785	32,243
Decrease (increase) in assets held for resale	(70)	51
Purchase of property and equipment	(15)	(117)
Proceeds from sale of property and equipment		9
Net cash provided by investing activities	10,527	7,130
Cash flows from financing activities		
Decrease on line of credit	(14,750)	(9,000)
Change in drafts payable	1,492	14
Proceeds from exercise of stock options	71	

Payment of loan origination fees	(200)	
Net cash provided by financing activities	(13,387)	(8,986)
Net increase in cash	2,355	4,862
Cash, beginning of period	2,626	2,855
Cash, end of period	\$ 4,981	\$ 7,717

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying consolidated balance sheet as of March 31, 2018, which has been derived from audited financial statements, and the accompanying unaudited interim consolidated financial statements of Nicholas Financial, Inc., a Canadian holding company incorporated under the laws of British Columbia (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 8 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, 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 earliest. 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 selling 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 June 30, 2018 and 2017 was 8.19% and 7.56%, respectively in relation to the total amount financed.

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.

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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 June 30, (In thousands, except per share amounts)	
	2018	2017
Numerator:		
Net income per consolidated statements of income	\$ 1,420	\$ 813
Less: Allocation of earnings to participating securities	(11)	(14)
Net income allocated to common stock	1,409	799
Basic earnings per share computation:		
Net income allocated to common stock	\$ 1,409	\$ 799
Weighted average common shares outstanding, including shares considered participating securities	7,890	7,851
Less: Weighted average participating securities outstanding	(71)	(131)
Weighted average shares of common stock	7,819	7,720
Basic earnings per share	\$ 0.18	\$ 0.10
Diluted earnings per share computation:		
Net income allocated to common stock	\$ 1,420	\$ 799
Undistributed earnings re-allocated to participating securities		
Numerator for diluted earnings per share	\$ 1,420	\$ 799
	7,819	7,720

Weighted average common shares outstanding for basic earnings per share		
Incremental shares from stock options	11	53
Weighted average shares and dilutive potential common shares	7,830	7,773
Diluted earnings per share	\$ 0.18	\$ 0.10

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 June 30, 2018 and 2017, potential shares of common stock from stock options totaling 116,100 and 155,000, 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 Contracts and Direct Loans and are detailed as follows:

	(In thousands)	
	June 30, 2018	March 31, 2018
Finance receivables	\$ 286,391	\$ 301,155
Accrued Interest	2,609	2,642
Unearned dealer discounts	(13,345)	(13,655)
Finance receivables, net of unearned dealer discounts	275,655	290,142
Allowance for credit losses	(19,065)	(20,266)
Finance receivables, net	\$ 256,590	\$ 269,876

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

	As of June 30,	
	2018	2017
Contract Portfolio		
Weighted APR	22.38%	22.34%
Weighted average discount	7.44%	7.37%
Weighted average term (months)	54	57
Number of active contracts	32,069	36,174

As of
June 30,