

NICHOLAS FINANCIAL INC  
Form 10-K  
June 14, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

---

**FORM 10-K**

---

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934**  
For the fiscal year ended March 31, 2007

**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)

**2454 McMullen Booth Road, Building C**

**Clearwater, Florida**

(Address of Principal Executive Offices)

**8736-3354**  
(I.R.S. Employer

Identification No.)

Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-K

(727) 726-0763

(Registrant's Telephone Number, Including Area Code)

---

**Securities registered under Section 12(b) of the Exchange Act: None**

**Securities registered under Section 12(g) of the Exchange Act:**

**Common Stock, no par value**

---

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer, large accelerated filer and non-accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The issuer's revenues for its most recent fiscal year ended March 31, 2007 were \$46,709,374.

As of June 8, 2007, 10,018,481 shares of the Registrant's Common Stock, no par value, were outstanding. The aggregate market value of the shares held by non-affiliates was approximately \$96,500,000

**DOCUMENTS INCORPORATED BY REFERENCE:**

Portions of the Registrant's definitive Proxy Statement and Information Circular for the 2007 Annual General Meeting of Shareholders currently scheduled to be held on August 7, 2007, expected to be filed with the Commission pursuant to Regulation 14A on or about July 2, 2007, are incorporated by reference in Part III, Items 10 through 14, of this Annual Report on Form 10-K.

---

**Table of Contents**

**NICHOLAS FINANCIAL, INC.**

**FORM 10-K ANNUAL REPORT**

**TABLE OF CONTENTS**

	<b>Page No.</b>
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	2
Item 1A. <u>Risk Factors</u>	12
Item 1B. <u>Unresolved Staff Comments</u>	19
Item 2. <u>Properties</u>	19
Item 3. <u>Legal Proceedings</u>	19
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	19
<b><u>PART II</u></b>	
Item 5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	20
Item 6. <u>Selected Financial Data</u>	23
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	38
Item 8. <u>Financial Statements and Supplementary Data</u>	38
Item 9. <u>Changes In and Disagreements With Accountants on Accounting and Financial Disclosure</u>	63
Item 9A. <u>Controls and Procedures</u>	63
Item 9B. <u>Other Information</u>	67
<b><u>PART III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	68
Item 11. <u>Executive Compensation</u>	68
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	68
Item 13. <u>Certain Relationships and Related Transactions and Director Independence</u>	68
Item 14. <u>Principal Accountant Fees and Services</u>	68
<b><u>PART IV</u></b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	69

---

**Table of Contents**

**Forward-Looking Information**

This Annual Report on Form 10-K 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 beliefs and assumptions, as well as information currently available to management. When used in this document, the words anticipate, estimate, expect, and similar expressions are intended to identify forward-looking statements. Although Nicholas Financial, Inc., including its subsidiaries (collectively the Company), believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Such statements are subject to certain risks, uncertainties and assumptions, including but not limited to the risk factors discussed under the caption Risk Factors set forth in Item 1A Risk Factors. 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 fluctuations in the economy, the degree and nature of competition, fluctuations in interest rates, the availability of capital at acceptable rates and terms, demand for consumer financing in the markets served by the Company, the Company's products and services, increases in the default rates experienced on retail installment sales Contracts, regulatory changes in the Company's existing and future markets, and the Company's ability to expand its business, including its ability to identify and complete acquisitions and integrate the operations of acquired businesses, to recruit and retain qualified employees, to expand into new markets and to maintain profit margins in the face of increased pricing competition. All forward-looking statements included in this Report are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statement. Prospective investors should also consult the risk factors described from time to time in the Company's filings made with the Securities and Exchange Commission, including its reports on Forms 10-Q, 8-K and 10-K and annual reports to shareholders.

**PART I**

**Item 1. Business**

**General**

Nicholas Financial, Inc. (Nicholas Financial-Canada) is a Canadian holding company incorporated under the laws of British Columbia in 1986. The business activities of Nicholas Financial-Canada are conducted through its two wholly-owned subsidiaries formed pursuant to the laws of the State of Florida, Nicholas Financial, Inc. (Nicholas Financial) and Nicholas Data Services, Inc., (NDS). Nicholas Financial is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales contracts (Contracts) for purchases of new and used automobiles and light trucks. To a lesser extent, Nicholas Financial also makes direct loans and sells consumer-finance related products. NDS is engaged in supporting and updating industry-specific computer application software for small businesses located primarily in the Southeast United States. Nicholas Financial's financing activities accounted for more than 99% of the Company's consolidated revenues for each of the fiscal years ended March 31, 2007, 2006 and 2005. NDS's activities accounted for less than 1% of consolidated revenues during the same periods.

Nicholas Financial-Canada, Nicholas Financial and NDS are hereafter collectively referred to as the Company. All financial information herein is designated in United States currency.

The Company's principal executive offices are located at 2454 McMullen Booth Road, Building C, Clearwater, Florida 33759, and its telephone number is (727) 726-0763.

**Table of Contents**

**Available Information**

The Company's filings with the U.S. Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, definitive proxy statements on Schedule 14A, current reports on Form 8-K, and any amendments to those reports filed pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934, are made available free of charge through the Investor Relations section of the Company's Internet website at <http://nicholasfinancial.com> as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the SEC. Copies of any materials the Company files with the SEC can also be obtained free of charge through the SEC's website at <http://www.sec.gov>, at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549, or by calling the SEC's Office of Investor Education and Assistance at 1-800-732-0330.

**Growth Strategy**

The Company's principal goals are to increase its profitability and its long-term shareholder value through greater penetration in its current markets and controlled geographic expansion into new markets. The Company also intends to continue its expansion through a proportionate increase in its origination of direct consumer loans. The Company is currently expanding its automobile financing program in the States of Georgia, Florida, North Carolina, South Carolina, Virginia, Michigan, Ohio, Kentucky, Indiana, Maryland, and Alabama. The Company has targeted certain geographic locations within these states where it believes there is a sufficient market for its automobile financing program. The Company's strategy is to monitor these markets and ultimately decide where and if it will open additional branch locations. The Company also continues to analyze other markets in states in which it does not currently operate. Although the Company has not made any bulk purchases of Contracts in the last five years, if the opportunity arises, the Company may consider possible acquisitions of portfolios of seasoned Contracts from dealers in bulk transactions as a means of further penetrating its existing markets or expanding its presence in targeted geographic locations. The Company cannot provide any assurances, however, that it will be able to further expand in either its current markets or any targeted new markets.

**Automobile Finance Business - Contracts**

The Company is engaged in the business of providing financing programs, primarily on behalf of purchasers of new and used cars and light trucks who meet the Company's credit standards, but who do not meet the credit standards of traditional lenders, such as banks and credit unions, because of the age of the vehicle being financed or the customer's job instability or credit history. Unlike traditional lenders, which look primarily to the credit history of the borrower in making lending decisions and typically finance new automobiles, the Company is willing to purchase Contracts for purchases made by borrowers who do not have a good credit history and for older model and high mileage automobiles. 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.

**Table of Contents**

The Company's automobile finance programs are currently conducted in eleven states through a total of 47 branch offices, consisting of nineteen in Florida, five in each of Ohio, Georgia and North Carolina, three in each of Kentucky and Virginia, two in each of Maryland and South Carolina, and one in each of Michigan, Alabama, and Indiana. As of March 31, 2007 the Company had non-exclusive agreements with approximately 2,000 dealers, of which approximately 1,500 are active, for the purchase of individual Contracts that meet the Company's financing criteria. The Company considers a dealer agreement to be active if the Company has purchased a Contract thereunder in the last six months. The dealer agreements require the dealer to originate Contracts in accordance with the Company's guidelines. Once a Contract is purchased by the Company the dealer is no longer involved in the relationship between the Company and the borrower, other than through the existence of limited representation and warranties of the dealer.

Customers under the Contracts typically make down payments, in the form of cash or trade-in, ranging from 5% to 20% of the sale price of the vehicle financed. The balance of the purchase price of the vehicle plus taxes, title fees and, if applicable, premiums for extended service Contracts, accident and health insurance and/or credit life insurance, are generally financed over a period of 12 to 72 months. Accident and health insurance coverage enables the customer to make required payments under the Contract in the event the borrower becomes unable to work because of illness or accident and credit life insurance pays the borrower's obligations under the Contract upon his or her death.

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed (the discount) by the purchaser of the automobile. The amount of the discount depends upon factors such as the age and value of the automobile and the creditworthiness of the customer. The Company will pay more (i.e., purchase the Contract at a smaller discount from the original principal amount) for Contracts as the credit risk of the customer improves. In certain markets, competition determines the discount that the Company can charge. Historically, the Contracts purchased by the Company have been purchased at discounts that range from 1% to 15% of the original principal amount of the Contract. In addition to the discount, the Company charges the dealer a processing fee of \$75 per Contract purchased. As of March 31, 2007, the Company's loan portfolio consisted exclusively of Contracts purchased without recourse to the dealer. Although all the Contracts in the Company's loan portfolio were acquired without recourse, each dealer remains liable to the Company for liabilities arising from certain representations and warranties made by the dealer with respect to compliance with applicable federal and state laws and valid title to the vehicle.

The Company's policy is to only purchase a Contract after the dealer has provided the Company with the requisite proof that the Company has a first priority lien on the financed vehicle (or the Company has, in fact, perfected such first priority lien), that the customer has obtained the required collision insurance naming the Company as loss payee and that the Contract has been fully and accurately completed and validly executed. Once the Company has received and approved all required documents, it pays the dealer for the Contract and commences servicing the Contract.

The Company requires the owner of the vehicle to obtain and maintain collision insurance, naming the Company as the loss payee, with a deductible of not more than \$500. Both the Company and the dealers offer purchasers of vehicles certain other add-on products. These products are offered by the dealer on behalf of the Company or on behalf of the dealership at the time of sale. They consist of a roadside assistance plan, extended warranty protection, gap insurance, credit life insurance, credit accident and health insurance, and credit property insurance. If the purchaser so desires, the cost of these products may be included in the amount financed under the Contract.

**Table of Contents****Contract Procurement**

The Company purchases Contracts in the states listed in the table below. The Contracts purchased by the Company are predominately for used vehicles; for the periods shown below, less than 3% were for new vehicles. The average model year collateralizing the portfolio as of March 31, 2007 was a 2001 vehicle. The dollar amounts shown in the table below represent the Company's finance receivables, net of unearned interest on Contracts purchased:

State	Maximum allowable interest rate (1)	Fiscal year ended March 31,		
		2007	2006	2005
Florida	18-30% (2)	\$ 54,398,960	\$ 50,382,674	\$ 44,304,705
Georgia	18-30% (2)	11,586,876	10,180,952	7,949,021
North Carolina	18-29% (2)	13,158,260	12,123,479	9,348,551
South Carolina	(3)	4,276,742	3,762,664	3,762,780
Ohio	25%	13,306,050	13,256,580	11,782,285
Virginia	(3)	7,027,766	7,689,661	5,767,526
Maryland	24%	3,697,468	2,660,706	885,941
Kentucky	18-25% (2)	6,452,075	4,089,311	659,838
Michigan	25%	2,000,130	2,363,510	2,700,315
Indiana	21%	2,874,907	2,847,976	385,749
Alabama	(3)	1,413,763		
Total		\$ 120,192,997	\$ 109,357,513	\$ 87,546,711

- 
- (1) The allowable maximum interest rates by state are subject to change and are governed by the individual states the Company conducts business in.
  - (2) The maximum allowable interest rate in each of these states varies depending upon the model year of the vehicle being financed. In addition, Georgia does not currently impose a maximum allowable interest rate with respect to Contracts over \$5,000.
  - (3) Neither of these states currently imposes a maximum allowable interest rate with respect to the types and sizes of Contracts the Company purchases. The maximum rate which the Company will typically charge any customer in each of these states is 29% per annum.

**Table of Contents**

The following table presents selected information on Contracts purchased by the Company, net of unearned interest:

Contracts	Fiscal year ended March 31,		
	2007	2006	2005
Purchases	\$ 120,192,997	\$ 109,357,513	\$ 87,546,711
Weighted APR	23.90%	24.03%	24.05%
Average discount	8.45%	8.78%	8.78%
Weighted average term (months)	46	45	44
Average loan	\$ 9,063	\$ 8,795	\$ 8,387
Number of contracts	13,262	12,434	10,439

**Direct Loans**

The Company currently originates direct loans in Florida, Georgia and North Carolina. Direct loans are loans originated directly between the Company and the consumer. These loans are typically for amounts ranging from \$1,000 to \$8,000 and are generally secured by a lien on an automobile, watercraft or other permissible tangible personal property. The average loan made to date by the Company had an initial principal balance of approximately \$3,500. The Company does not expect the average loan size to increase significantly within the foreseeable future. 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. The Company does not have a direct loan license in Ohio, South Carolina, Michigan, Kentucky, Maryland, Indiana, Alabama or Virginia, and none is presently required in Georgia (as the Company currently does not make direct loans under \$3,000 in that state). Typically, the Company allows for a seasoning process to occur in a new market prior to determining whether to pursue a direct loan license there. The Company expects to make a decision in the current fiscal year on whether or not to pursue a direct loan license for Ohio. The Company does not expect to pursue a direct loan license in any other state during the current fiscal year. The size of the loan and maximum interest rate that can be charged vary from state to state. 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 the direct consumer 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. The Company's direct loan program was implemented in April 1995 and currently accounts for approximately 4% of annual consolidated revenues for the Company. As of March 31, 2007, loans made by the Company pursuant to its direct loan program constituted approximately 4% of the aggregate principal amount of the Company's loan portfolio.

**Table of Contents**

In connection with its direct loan program, the Company also offers health and accident insurance coverage and credit life insurance to customers. Customers in approximately 79% of the 2,672 direct loan transactions outstanding as of March 31, 2007 had elected to purchase insurance coverage offered by the Company. The cost of this insurance is included in the amount financed by the customer.

The following table presents selected information on direct loans originated by the Company, net of unearned interest:

Direct loan originations	Fiscal year ended March 31,		
	2007	2006	2005
Originations	\$ 8,672,700	\$ 7,936,013	\$ 5,198,638
Weighted APR	25.30%	25.65%	25.90%
Weighted average term (months)	31	28	27
Average loan	\$ 3,459	\$ 3,399	\$ 3,168
Number of contracts	2,507	2,335	1,641

**Underwriting Guidelines**

The Company's typical customer has a credit history that fails to meet the lending standards of most banks and credit unions. Among the credit problems experienced by the Company's customers that resulted in a poor credit history are: unpaid revolving credit card obligations; unpaid medical bills; unpaid student loans; prior bankruptcy; and evictions for nonpayment of rent. The Company believes that its customer profile is similar to that of its direct competitors.

Prior to its approval of the purchase of a Contract, the Company is provided with a standardized credit application completed by the consumer which contains information relating to the consumer's background, employment, and credit history. The Company also obtains credit reports from Equifax, TRW or TransUnion, which are independent credit reporting services. The Company verifies the consumer's employment history, income and residence. In most cases, consumers are interviewed by telephone by a Company application processor.

The Company has established internal buying guidelines to be used by its Branch Managers and internal underwriters when purchasing Contracts. Any Contract that does not meet these guidelines must be approved by the senior management of the Company. The Company currently has District Managers charged with managing the specific branches in a defined geographic area. In addition to a variety of administrative duties, the District Managers are responsible for monitoring their assigned branches' compliance with the Company's underwriting standards.

The Company uses essentially the same criteria in analyzing a direct loan as it does in analyzing the purchase of a Contract. Lending decisions regarding direct loans are made based upon a review of the customer's loan application, credit history, job stability, income, in-person interviews with a Company loan officer and the value of the collateral offered by the borrower to secure the loan. To date, since approximately 90% of the Company's direct loans have been made to individuals whose automobiles have been financed by the Company, the customer's payment history under his or her existing or past Contract is a significant factor in the lending decision. The decision process with respect to the purchase of Contracts is similar, although the customer's prior payment history with automobile loans is weighted more heavily in the decision-making process and the collateral value of the automobile being financed is also considered.

## **Table of Contents**

After reviewing the information included in the Contract or direct loan application and taking the other factors into account, a Company employee categorizes the customer using internally developed credit classifications of 1, indicating higher creditworthiness, through 5, indicating lower creditworthiness. In the absence of other factors, such as a favorable payment history on a Contract held by the Company, the Company generally makes direct loans only to individuals rated in categories 3 or higher. Contracts are financed for individuals who fall within all five acceptable rating categories utilized, 1 through 5 .

Usually a customer who falls within the two highest categories is purchasing a two to four-year old, low mileage used automobile from the inventory of a new car or franchise dealer, while a customer in either of the two lowest categories is purchasing an older, high mileage automobile from an independent used automobile dealer.

The Company utilizes its Loss Recovery Department ( LRD ) to perform on-site audits of branch compliance with Company underwriting guidelines. LRD audits Company branches on a schedule that is variable depending on the size of the branch, length of time a branch has been open, current tenure of the Branch Manager, previous branch audit score and current and historical branch profitability. LRD reports directly to the Accounting and Administrative Management of the Company. The Company believes that an independent review and audit of its branches that is not tied to the sales function of the Company is imperative in order to assure the information obtained is impartial.

## **Monitoring and Enforcement of Contracts**

The Company requires all customers to obtain and maintain collision insurance covering damage to the vehicle. Failure to maintain such insurance constitutes a default under the Contract, and the Company may, at its discretion, repossess the vehicle. To reduce potential loss due to insurance lapse, the Company has the contractual right to force place its own collateral protection insurance policy, which covers loss due to physical damage to vehicles not covered by collision insurance.

The Company s Management Information Services personnel maintain a number of reports to monitor compliance by customers with their obligations under Contracts and direct loans made by the Company. These reports may be accessed on a real-time basis throughout the Company by management personnel, including Branch Managers and staff, at computer terminals located in the main office and each branch office. These reports include delinquency aging reports, insurance due reports, customer promises reports, vehicle information reports, purchase reports, dealer analysis reports, static pool reports, and repossession reports.

A delinquency report is an aging report that provides basic information regarding each account and indicates accounts that are past due. The report includes information such as the account number, address of the customer, home and work phone numbers of the customer, original term of the Contract, number of remaining payments, outstanding balance, due dates, date of last payment, number of days past due, scheduled payment amount, amount of last payment, total past due, and special payment arrangements or agreements.

Any account that is less than 120 days old is included on the delinquency report on the first day that the Contract is contractually past due. After an account has matured more than 120 days, it is not included on the delinquency report until it is 11 days past due. Once an account becomes 30 days past due, repossession proceedings are implemented unless the customer provides the Company with an acceptable explanation for the delinquency and displays a willingness and the ability to make the payment, and commits to a plan to return the account to current status. When an account is 60 days past due, the Company ceases recognition of income on the Contract and repossession proceedings are initiated. At 120 days delinquent, if the vehicle has not yet been repossessed, the account is written off. Once a vehicle has been repossessed, the related loan balance no longer appears on the delinquency report. Instead, the vehicle appears on the Company s repossession report and is sold, either at auction or to an automobile dealer.

## **Table of Contents**

When an account becomes delinquent, the Company immediately contacts the customer to determine the reason for the delinquency and to determine if appropriate arrangements for payment can be made. If payment arrangements acceptable to the Company can be made, the information is entered in its database and is used to generate a Promises Report, which is utilized by the Company's collection staff for account follow up.

The Company generates an insurance report to monitor compliance with the insurance obligations imposed upon its customers. This report includes the account number, name and address of the customer, and information regarding the insurance carrier, as well as summarizes the insurance coverage, identifies the expiration date of the policy, and provides basic information regarding payment dates and the term of the Contract. This report assists the Company in identifying customers whose insurance policies are up for renewal or are in jeopardy of being canceled. The Company sends written notices to, and makes direct contact with, customers whose insurance policies are about to lapse or be canceled. If a customer fails to provide proof of coverage within 30 days of notice, the Company has the option of purchasing insurance and adding the cost and applicable finance charges to the balance of the Contract.

The Company prepares a repossession report that provides information regarding repossessed vehicles and aids the Company in disposing of repossessed vehicles. In addition to information regarding the customer, this report provides information regarding the date of repossession, date the vehicle was sold, number of days it was held in inventory prior to sale, year and make and model of the vehicle, mileage, payoff amount on the Contract, NADA book value, Black Book value, suggested sale price, location of the vehicle, original dealer and condition of the vehicle, and notes other information that may be helpful to the Company.

The Company also prepares a dealer analysis report that provides information regarding each dealer from which it purchases Contracts. This report allows the Company to analyze the volume of business done with each dealer and the terms on which it has purchased Contracts from the dealer.

The Company's policy is to aggressively pursue legal remedies to collect deficiencies from customers. Delinquency notices are sent to customers and verbal requests for payment are made beginning when an account becomes 11 days delinquent. When an account becomes 30 days delinquent and the customer has not made payment arrangements acceptable to the Company or has failed to respond to the requests for payment, a repossession request form is prepared by the responsible branch office employee for approval by the Branch Manager for the vicinity in which the borrower lives. Once the repossession request has been approved, first by the Branch Manager and secondly by the applicable District Manager, it must then be approved by the Director of Loss Recovery. The reposessor delivers the vehicle to a secure location specified by the Company. The Company maintains relationships with several licensed repossession firms that repossess vehicles for fees that range from \$175 to \$350 for each vehicle repossessed. As required by Florida, Georgia, North Carolina, South Carolina, Ohio, Michigan, Indiana, Maryland, Kentucky, Alabama and Virginia law, the customer is notified by certified letter that the vehicle has been repossessed and that to regain the vehicle, he or she must make arrangements satisfactory to the Company and pay the amount owed under the Contract within ten days after delivery of the letter.

The minimum requirement for return of the vehicle is payment of all past due amounts under the Contract and all expenses associated with the repossession incurred by the Company. If satisfactory arrangements for return of the vehicle are not made within the statutory period, the Company then sends title to the vehicle to the applicable state title transfer department, which then registers the vehicle in the name of the Company. The Company then either sells the vehicle to a dealer or has it transported to an automobile auction for sale. On average, approximately 30 days lapse between the time the Company takes possession of a vehicle and the time it is sold to a dealer or at auction. When the Company determines that there is a reasonable likelihood of recovering part or all of any deficiency against the customer under the Contract, it pursues legal remedies available to it, including lawsuits, judgement liens and wage garnishments. Historically, the Company has recovered approximately 10-15% of deficiencies from such customers. Proceeds from the disposition of the vehicles are not included in calculating the foregoing percentage range.

## **Table of Contents**

### **Marketing and Advertising**

The Company's Contract marketing efforts currently are directed exclusively toward automobile dealers. The Company attempts to meet dealers needs by offering highly-responsive, cost-competitive and service-oriented financing programs. The Company relies on its District and Branch Managers to solicit agreements for the purchase of Contracts with automobile dealers located within a 25-mile radius of each branch office. The Branch Manager provides dealers with information regarding the Company and the general terms upon which the Company is willing to purchase Contracts. The Company presently has no plans to implement any other forms of advertising, such as radio or newspaper advertisements, for the purchase of Contracts.

The Company solicits customers under its direct loan program primarily through direct mailings, followed by telephone calls, to individuals who have a good credit history with the Company in connection with Contracts purchased by the Company.

### **Computerized Information System**

The Company utilizes integrated computer systems developed by NDS to assist in responding to customer inquiries and to monitor the performance of its Contract and direct loan portfolio and the performance of individual customers under Contracts. All Company personnel are provided with instant, simultaneous access to information from a single shared database. The Company has created specialized programs to automate the tracking of Contracts and direct loans from inception. The Company's computer network encompasses both its corporate headquarters and its branch office locations. See Monitoring and Enforcement of Contracts above for a summary of the different reports prepared by the Company.

### **Competition**

The consumer finance industry is highly fragmented and highly competitive. There are numerous financial service companies that provide consumer credit in the markets served by the Company, including banks, other consumer finance companies, and captive finance companies owned by automobile manufacturers and retailers. Many of these companies have significantly greater resources than the Company. The Company does not believe that increased competition for the purchase of Contracts will cause a material reduction in the interest rate payable by an individual purchaser of an automobile for the foreseeable future. However, increased competition for the purchase of Contracts will enable automobile dealers to shop for the best price, thereby giving rise to an erosion in the discount from the initial principal amounts at which the Company would be willing to purchase Contracts.

The Company's target market consists of persons who are generally unable to obtain traditional used car financing because of their credit history or the vehicle's mileage or age. The Company has been able to expand its automobile finance business in the non-prime credit market by offering to purchase Contracts on terms that are competitive with those of other companies which purchase automobile receivables in that market segment. Because of the daily contact that many of its employees have with automobile dealers located throughout the market areas served by it, the Company is generally aware of the terms upon which its competitors are offering to purchase Contracts. The Company's policy is to modify its terms, if necessary, to remain competitive. However, the Company will not sacrifice credit quality, its purchasing criteria or prudent business practices in order to meet the competition.

The Company's ability to compete effectively with other companies offering similar financing arrangements depends upon maintaining close business relationships with dealers of new and used vehicles. No single dealer out of the approximately 1,500 dealers that the Company currently has active Contractual relationships with accounted for over 1% of its business volume for any of the fiscal years ended March 31, 2007, 2006 or 2005.

---

**Table of Contents**

**Regulation**

The Company's financing operations are subject to regulation, supervision and licensing under various federal, state and local statutes and ordinances. Additionally, the procedures that the Company must follow in connection with the repossession of vehicles securing Contracts are regulated by each of the states in which the Company does business. To date, the Company's operations have been conducted exclusively in the states of Florida, Georgia, Michigan, North Carolina, Ohio, South Carolina, Kentucky, Maryland, Indiana, Alabama and Virginia. Accordingly, the laws of such states, as well as applicable federal law, govern the Company's operations. Compliance with existing laws and regulations has not had a material adverse effect on the Company's operations to date. The Company's management believes that the Company maintains all requisite licenses and permits and is in material compliance with all applicable local, state and federal laws and regulations. The Company periodically reviews its branch office practices in an effort to ensure such compliance. The following constitute certain of the federal, state and local statutes and ordinances with which the Company must comply:

*State consumer regulatory agency requirements.* Pursuant to regulations of the state of Florida governing the Company's financing business activities, the Florida Department of Banking and Finance periodically conducts an on-site audit of each of the Company's Florida branches to monitor compliance with applicable regulations. These regulations govern, among other matters, licensure requirements, requirements for maintenance of proper records, payment of required fees, maximum interest rates that may be charged on loans to finance used vehicles and proper disclosure to customers regarding financing terms. Pursuant to North Carolina law, the Company's direct loan activities in that state are subject to similar periodic on-site audits by the North Carolina Office of the Commissioner of Banks.

*State licensing requirements.* The Company maintains a Sales Finance Company License with the Florida Department of Banking and Finance, as well as consumer loan licenses in Florida and North Carolina. In addition, each of the dealers that the Company does business with is required to maintain a Retail Installment Seller's License with each state in which it operates.

*Fair Debt Collection Act.* The Fair Debt Collection Act and applicable state law counterparts prohibit the Company from contacting customers during certain times and at certain places, from using certain threatening practices and from making false implications when attempting to collect a debt.

*Truth in Lending Act.* The Truth in Lending Act requires the Company and the dealers it does business with to make certain disclosures to customers, including the terms of repayment, the total finance charge and the annual percentage rate charged on each Contract or direct loan.

*Equal Credit Opportunity Act.* The Equal Credit Opportunity Act prohibits creditors from discriminating against loan applicants on the basis of race, color, sex, age or marital status. Pursuant to Regulation B promulgated under the Equal Credit Opportunity Act, creditors are required to make certain disclosures regarding consumer rights and advise consumers whose credit applications are not approved of the reasons for the rejection.

*Fair Credit Reporting Act.* The Fair Credit Reporting Act requires the Company to provide certain information to consumers whose credit applications are not approved on the basis of a report obtained from a consumer-reporting agency.

*Gramm-Leach-Bliley Act.* The Gramm-Leach-Bliley Act requires the Company to maintain privacy with respect to certain consumer data in its possession and to periodically communicate with consumers on privacy matters.

---

**Table of Contents**

*Soldiers and Sailors Civil Relief Act.* The Soldiers and Sailors Civil Relief Act requires the Company to reduce the interest rate charged on each loan to customers who have subsequently joined, enlisted, been inducted or called to active military duty.

*Electronic Funds Transfer Act.* The Electronic Funds Transfer Act prohibits the Company from requiring its customers to repay a loan or other credit by electronic funds transfer ( EFT ), except in limited situations which do not apply to the Company. The Company is also required to provide certain documentation to its customers when an EFT is initiated and to provide certain notifications to its customers with regard to preauthorized payments.

*Telephone Consumer Protection Act.* The Telephone Consumer Protection Act prohibits telephone solicitation calls to a customer s home before 8 a.m. or after 9 p.m. In addition, if the Company makes a telephone solicitation call to a customer s home, the representative making the call must provide his or her name, the Company s name, and a telephone number or address at which the Company s representative may be contacted. The Telephone Consumer Protection Act also requires that the Company maintain a record of any requests by customers not to receive future telephone solicitations, which must be maintained for five years.

*Bankruptcy.* Federal bankruptcy and related state laws may interfere with or affect the Company s ability to recover collateral or enforce a deficiency judgment.

**Employees**

The Company s management and various support functions are centralized at the Company s Corporate Headquarters in Clearwater, Florida. As of March 31, 2007 the Company employed a total of 236 persons, three of whom work for NDS and 233 of whom work for Nicholas Financial. None of the Company s employees is subject to a collective bargaining agreement, and the Company considers its relations with its employees generally to be good.

**Item 1A. Risk Factors**

*The following factors, as well as other factors not set forth below, may adversely effect the business, operations, financial condition or results of operations of the Company (sometimes referred to in this section as we us or our ).*

**Our profitability and future growth depend on our continued access to bank financing.**

The profitability and growth of our business currently depend on our ability to access bank debt at competitive rates. We currently depend on a \$110.0 million line of credit facility with a financial institution to finance our purchases of Contracts and fund our direct loans. This line of credit currently has a maturity date of November 30, 2008 and is secured by substantially all our assets. At March 31, 2007, we had approximately \$94.0 million outstanding under the line of credit and approximately \$16.0 million available for additional borrowing.

The availability of our credit facility depends, in part, on factors outside of our control, including regulatory capital treatment for unfunded bank lines of credit and the availability of bank loans in general. Therefore, we cannot guarantee that this credit facility will continue to be available beyond the current maturity date on reasonable terms or at all. If we are unable to renew or replace our credit facility or find alternative financing at reasonable rates, we may be forced to liquidate. We will continue to depend on the availability of our line of credit, together with cash from operations, to finance our future operations.

**Table of Contents**

**The terms of our indebtedness impose significant restrictions on us.**

Our existing outstanding indebtedness restricts our ability to, among other things:

sell or transfer assets;

incur additional debt;

repay other debt;

pay dividends;

make certain investments or acquisitions;

repurchase or redeem capital stock;

engage in mergers or consolidations; and

engage in certain transactions with subsidiaries and affiliates.

In addition, our line of credit facility requires us to comply with certain financial ratios and covenants and to satisfy specified financial tests, including maintenance of asset quality and portfolio performance tests. Our ability to continue to meet those financial ratios and tests could be affected by events beyond our control. Failure to meet any of these covenants, financial ratios or financial tests could result in an event of default under our line of credit facility. If an event of default occurs under this credit facility, the lender may take one or more of the following actions:

increase our borrowing costs;

restrict our ability to obtain additional borrowings under the facility;

accelerate all amounts outstanding under the facility; or

enforce its interests against collateral pledged under the facility.

If our lender accelerates our debt payments, our assets may not be sufficient to fully repay the debt.

**We will require a significant amount of cash to service our indebtedness and meet our other liquidity needs.**

Our ability to make payments on or to refinance our indebtedness and to fund our operations and planned capital expenditures depends on our future operating performance. Our primary cash requirements include the funding of:

Contract purchases and direct loans;

interest payments under our line of credit facility and other indebtedness;

capital expenditures for technology and facilities;

ongoing operating expenses;

planned expansions by opening additional branch offices; and

any required income tax payments.

## **Table of Contents**

In addition, because we expect to continue to require substantial amounts of cash for the foreseeable future, we may seek additional debt or equity financing. The type, timing and terms of the financing we select will be dependent upon our cash needs, the availability of other financing sources and the prevailing conditions in the financial markets. There is no assurance that any of these sources will be available to us at any given time or that on reasonable terms on which these sources may be available will be favorable. Our inability to obtain such additional financing on reasonable terms could adversely impact our ability to grow.

### **Our substantial indebtedness could adversely affect our financial condition.**

We currently have a substantial amount of outstanding indebtedness. Our ability to make payments on, or to refinance, our indebtedness will depend on our future operating performance, including our ability to access additional debt and equity financing, which, to a certain extent, is subject to economic, financial, competitive and other factors beyond our control.

### **Our high level of indebtedness could have important consequences for our business. For example,**

we may be unable to satisfy our obligations under our outstanding indebtedness;

we may find it more difficult to fund future working capital, capital expenditures, acquisitions, and general corporate needs;

we may have to dedicate a substantial portion of our cash resources to the payments on our outstanding indebtedness, thereby reducing the funds available for operations and future business opportunities; and

we may be more vulnerable to adverse general economic and industry conditions.

We may incur substantial additional debt in the future. If new debt is added to our current levels, the risks described above could intensify.

### **We may experience high delinquency rates in our loan portfolios, which could reduce our profitability.**

Our profitability depends, to a material extent, on the performance of Contracts that we purchase. Historically, we have experienced higher delinquency rates than traditional financial institutions because a large portion of our loans are to non-prime borrowers, who are unable to obtain financing from traditional sources due to their credit history. Although we attempt to mitigate these high credit risks with our underwriting standards and collection procedures, these standards and procedures may not offer adequate protection against the risk of default. In the event of a default, the collateral value of the financed vehicle usually does not cover the outstanding loan balance and costs of recovery. Higher than anticipated delinquencies and defaults on our Contracts would reduce our profitability.

In addition, in the event we were to make any bulk purchases of seasoned Contracts, we may experience higher than normal delinquency rates with respect to these loan portfolios due to our inability to apply our underwriting standards to each loan comprising the acquired portfolios. We would similarly attempt to mitigate the high credit risks associated with these loans, although no assurances can be given that we would be able to do so.

### **We depend upon our relationships with our dealers.**

Our business depends in large part upon our ability to establish and maintain relationships with reputable dealers who originate the Contracts we purchase. Although we believe we have been successful in developing and maintaining such relationships, such relationships are not exclusive, and many of them are not longstanding. There can be no assurances that we will be successful in maintaining such relationships or increasing the number of dealers with whom we do business, or that our existing dealer base will continue to generate a volume of Contracts comparable to the volume of such Contracts historically generated by such dealers.

## **Table of Contents**

### **Our success depends upon our ability to implement our business strategy.**

Our financial position depends on management's ability to execute our business strategy. Key factors involved in the execution of our business strategy include achievement of the desired Contract purchase volume, the use of effective risk management techniques and collection methods, continued investment in technology to support operating efficiency and continued access to significant funding and liquidity sources. Our failure or inability to execute any element of our business strategy could materially adversely affect our financial condition.

### **Our business is highly dependent upon general economic conditions.**

During periods of economic slowdown or recession, delinquencies, defaults, repossessions and losses generally increase. These periods also may be accompanied by decreased consumer demand for automobiles and declining values of automobiles securing outstanding loans, which weakens collateral coverage on our loans and increases the amount of a loss we would experience in the event of default. Significant increases in the inventory of used automobiles during periods of economic recession may also depress the prices at which repossessed automobiles are sold or delay the timing of these sales. Because we focus on non-prime borrowers, the actual rates of delinquencies, defaults, repossessions and losses on these loans are higher than those experienced in the general automobile finance industry and could be more dramatically affected by a general economic downturn. In addition, during an economic slowdown or recession, our servicing costs may increase without a corresponding increase in our servicing income. While we seek to manage the higher risk inherent in loans made to non-prime borrowers through our underwriting criteria and collection methods, no assurance can be given that these criteria or methods will afford adequate protection against these risks. Any sustained period of increased delinquencies, defaults, repossessions or losses or increased servicing costs could adversely affect our financial condition.

### **Decreased auction proceeds resulting from the depressed prices at which used automobiles may be sold during periods of economic slowdown or recession will reduce our profitability.**

If we repossess a vehicle securing a Contract, we typically have it transported to an automobile auction for sale. Auction proceeds from the sale of repossessed vehicles and other recoveries are usually not sufficient to cover the outstanding balance of the Contract, and the resulting deficiency is charged off. In addition, there is, on average, approximately a 30-day lapse between the time we repossess a vehicle and the time it is sold by a dealer or at auction. Furthermore, depressed wholesale prices for used automobiles may result from significant liquidations of rental or fleet inventories, and from increased volume of trade-ins due to promotional financing programs offered by new vehicle manufacturers. During periods of economic slowdown or recession, decreased auction proceeds resulting from the depressed prices at which used automobiles may be sold will result in our experiencing higher credit losses.

### **An increase in market interest rates may reduce our profitability.**

Our long-term profitability may be directly affected by the level of and fluctuations in interest rates. Sustained, significant increases in interest rates may adversely affect our liquidity and profitability by reducing the interest rate spread between the rate of interest we receive on our Contracts and interest rates that we pay under our outstanding line of credit facility. As interest rates increase, our gross interest rate spread on new originations will generally decline since the rates charged on the Contracts originated or purchased from dealers generally are limited by statutory maximums, restricting our opportunity to pass on increased interest costs. We monitor the interest rate environment and have entered into interest rate swap agreements relating to a portion of our outstanding debt with maturities ranging from April 2, 2007 through September 10, 2010. Each of these agreements effectively converts a portion of our floating-rate debt to a fixed-rate, thus reducing the impact of interest rate changes on our interest expense. These interest rate swap agreements may not adequately mitigate the impact of changes in interest rates, however, and we may not be able to enter into such agreements in the future.

## **Table of Contents**

### **Our growth depends upon our ability to retain and attract a sufficient number of qualified employees.**

To a large extent, our growth strategy depends on the opening of new offices that will focus primarily on purchasing Contracts and making direct loans in markets we have not previously served. Future expansion of our office network depends upon our ability to attract and retain qualified and experienced office managers and the ability of such managers to develop relationships with dealers that serve those markets. We generally do not open new offices until we have located and hired a qualified and experienced individual to manage the office. Typically, this individual will be familiar with local market conditions and have existing relationships with dealers in the area to be served. Although we believe that we can attract and retain qualified and experienced personnel as we proceed with planned expansion into new markets, no assurance can be given that we will be successful in doing so. Competition to hire personnel possessing the skills and experience required by us could contribute to an increase in our employee turnover rate. High turnover or an inability to attract and retain qualified personnel could have an adverse effect on our origination, delinquency, default and net loss rates and, ultimately, our financial condition.

### **The loss of one of our key executives could have a material adverse effect on our business.**

Our growth and development to date have been largely dependent upon the services of Peter L. Vosotas, our Chairman of the Board, President and Chief Executive Officer, and Ralph T. Finkenbrink, our Chief Financial Officer and Senior Vice President. We do not maintain key-man life insurance policies on these executives. Although we believe that we have sufficient additional experienced management personnel to accommodate the loss of any key executive, the loss of services of one or both of these executives could have a material adverse effect on us.

### **We are subject to risks associated with litigation.**

As a consumer finance company, we are subject to various consumer claims and litigation seeking damages and statutory penalties, based upon, among other things:

usury laws;

disclosure inaccuracies;

wrongful repossession;

violations of bankruptcy stay provisions;

certificate of title disputes;

fraud;

breach of contract; and

discriminatory treatment of credit applicants.

Some litigation against us could take the form of class action complaints by consumers. As the assignee of Contracts originated by dealers, we may also be named as a co-defendant in lawsuits filed by consumers principally against dealers. The damages and penalties claimed by consumers in these types of actions can be substantial. The relief requested by the plaintiffs varies but may include requests for compensatory, statutory and punitive damages. No assurances can be given that we will not experience material financial losses in the future as a result of litigation and other legal proceedings.



## **Table of Contents**

**We are subject to many laws and governmental regulations, and any material violations of or changes in these laws or regulations could have a material adverse effect on our financial condition and business operations.**

Our financing operations are subject to regulation, supervision and licensing under various federal, state and local statutes and ordinances. Additionally, the procedures that we must follow in connection with the repossession of vehicles securing Contracts are regulated by each of the states in which we do business. The various federal, state and local statutes, regulations, and ordinances applicable to our business govern, among other things:

licensing requirements;

requirements for maintenance of proper records;

payment of required fees to certain states;

maximum interest rates that may be charged on loans to finance new and used vehicles;

debt collection practices;

proper disclosure to customers regarding financing terms;

privacy regarding certain customer data;

interest rates on loans to customers;

telephone solicitation of direct loan customers; and

collection of debts from loan customers who have filed bankruptcy.

We believe that we maintain all material licenses and permits required for our current operations and are in substantial compliance with all applicable local, state and federal regulations. Our failure, or failure by dealers who originate the Contracts we purchase, to maintain all requisite licenses and permits, and to comply with other regulatory requirements, could result in consumers having rights of rescission and other remedies that could have a material adverse effect on our financial condition. Furthermore, any changes in applicable laws, rules and regulations may make our compliance therewith more difficult or expensive or otherwise adversely affect our financial condition.

**Our Chief Executive Officer and certain members of the Mahan family hold a significant percentage of our common stock and may take actions adverse to your interests.**

Peter L. Vosotas, our Chairman of the Board, President and Chief Executive Officer, and certain members of the Mahan family, including the adult children of Marvin and Ingrid Mahan, and certain entities controlled by them, owned approximately 15.5% and 10.4%, respectively, of our common stock as of June 13, 2007. As a result, they may be able to significantly influence matters requiring shareholder approval, including the election and removal of directors and approval of significant corporate transactions, such as mergers, consolidations and sales of assets. This concentration of ownership could have the effect of delaying, deferring or preventing a change in control or impeding a merger or consolidation, takeover or other business combination, which could cause the market price of our common stock to fall or prevent you from receiving a

premium in such transaction.

## **Table of Contents**

### **Our stock is not heavily traded, which may limit your ability to resell your shares.**

The average daily trading volume of our shares on the NASDAQ Global Select Market for the period from April 1, 2006 through March 31, 2007 was approximately 17,400 shares. Thus, our common stock is thinly traded. Thinly traded stock can be more volatile than stock trading in an active public market. Factors such as our financial results, the introduction of new products and services by us or our competitors, and various factors affecting the consumer-finance industry generally may have a significant impact on the market price of our common stock. In recent years, the stock market has experienced a high level of price and volume volatility, and market prices for the stocks of many companies have experienced wide price fluctuations that have not necessarily been related to their operating performance. Therefore, our shareholders may not be able to sell their shares at the volumes, prices, or times that they desire.

### **We operate in a competitive market.**

The non-prime consumer-finance industry is highly competitive. There are numerous financial service companies that provide consumer credit in the markets served by us, including banks, credit unions, other consumer finance companies and captive finance companies owned by automobile manufacturers and retailers. Many of these competitors have substantially greater financial resources than us. In addition, our competitors often provide financing on terms more favorable to automobile purchasers or dealers than we offer. Many of these competitors also have long-standing relationships with automobile dealerships and may offer dealerships or their customers other forms of financing, including dealer floor-plan financing and leasing, which are not provided by us. Providers of non-prime consumer financing have traditionally competed primarily on the basis of:

interest rates charged;

the quality of credit accepted;

the flexibility of loan terms offered;

the quality of service provided.

Our ability to compete effectively with other companies offering similar financing arrangements depends on maintaining close relationships with dealers of new and used vehicles. We may not be able to compete successfully in this market or against these competitors.

We have focused on a segment of the market composed of consumers who typically do not meet the more stringent credit requirements of traditional consumer financing sources and whose needs, as a result, have not been addressed consistently by such financing sources. If, however, other providers of consumer financing were to assert a significantly greater effort to penetrate our targeted market segment, we may have to reduce our interest rates and fees in order to maintain our market share. Any reduction in our interest rates or fees could have an adverse impact on our profitability or financial condition.

### **We may experience problems with our integrated computer systems or be unable to keep pace with developments in technology.**

We use various technologies in our business, including telecommunication, data processing, and integrated computer systems. Technology changes rapidly. Our ability to compete successfully with other financing companies may depend on whether we can exploit technological changes. We may not be able to exploit technological changes, and any investment we make in this area may not make us more profitable.

## **Table of Contents**

We utilize integrated computer systems to respond to customer inquiries and to monitor the performance of our Contract and direct loan portfolios and the performance of individual customers under our Contracts and direct loans. Problems with our systems operations could adversely impact our ability to monitor our portfolios or collect amounts due under our Contracts and direct loans, which could have a material adverse effect on our financial condition.

### **Item 1B. Unresolved Staff Comments**

None

### **Item 2. Properties**

The Company leases its Corporate Headquarters and branch office facilities. The Company's Headquarters, located at 2454 McMullen Booth Road, Building C, in Clearwater, Florida, consist of approximately 13,500 square feet of office space. The current lease relating to this space expires in January 2010.

Each of the Company's 47 branch offices located in Florida, Georgia, North Carolina, South Carolina, Michigan, Virginia, Ohio, Indiana, Maryland, Alabama and Kentucky consists of approximately 1,200 square feet of office space. These offices are located in office parks, shopping centers or strip malls and are occupied pursuant to leases with an initial term of from two to five years at annual rates ranging from approximately \$9.00 to \$24.00 per square foot. The Company believes that these facilities and additional or alternate space available to it are adequate to meet its needs for the foreseeable future.

### **Item 3. Legal Proceedings**

As previously reported, on April 8, 2004, the defendant in a deficiency action brought by the Company under the Ohio Uniform Commercial Code, filed a counterclaim in Cleveland Municipal Court, Cuyahoga County, Ohio, on behalf of a putative class of all persons who purchased motor vehicles pursuant to retail installment sales agreements later assigned to the Company, which motor vehicles were subsequently repossessed in Ohio by the Company or its agents (Nicholas Financial, Inc. v. Sanborn, Case No. 2004 CVI 6969). The defendant counter-plaintiff's counterclaim alleged, among other things, that the Company violated the Ohio Retail Installment Sales Act, the Ohio Uniform Commercial Code and the Ohio Consumer Sales Practices Act by: failing to provide members of the putative class with accurate disclosures of their statutory rights upon repossession; unilaterally abrogating those rights in the Company's repossession procedures; and improperly collecting deficiencies from members of the putative class. Pursuant to the counterclaim, the counter-plaintiff sought compensatory, statutory and punitive damages (including compensatory damages of at least \$500,000 pursuant to one alleged cause of action), prejudgment interest and attorneys' fees and expenses, as well as injunctive and other equitable relief, including a restitution remedy.

In March 2005, the parties engaged in voluntary mediation and reached a settlement subsequently approved by the court in March 2006, pursuant to which the Company paid the defendant counter-plaintiff an aggregate of \$135,000 (including \$40,000 in legal fees and expenses) in settlement of all claims in this action.

Except as described above, 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 position.

### **Item 4. Submission of Matters to a Vote of Security Holders**

No matters were submitted to a vote of security holders during the fourth quarter ended March 31, 2007.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Purchases of Equity Securities**

The Company's common stock trades on the NASDAQ Global Select Market under the symbol NICK.

The following table sets forth the high and low sales prices of the Company's common stock for the years ended March 31, 2007 and 2006, respectively.

	High	Low
<b>Fiscal year ended March 31, 2007</b>		
First Quarter	\$ 14.50	\$ 11.51
Second Quarter	\$ 14.50	\$ 12.75
Third Quarter	\$ 14.00	\$ 11.10
Fourth Quarter	\$ 12.07	\$ 10.36
<b>Fiscal year ended March 31, 2006</b>		
First Quarter	\$ 13.07	\$ 9.83
Second Quarter	\$ 11.75	\$ 9.90
Third Quarter	\$ 11.04	\$ 9.74
Fourth Quarter	\$ 13.25	\$ 10.35

As of June 1, 2007, there were approximately 3,200 holders of record of the Company's common stock.

On May 12, 2005, the Company's Board of Directors declared a three-for-two stock split on the Company's outstanding shares of common stock, payable on June 17, 2005 in the form of a 50% stock dividend, to shareholders of record as of the close of business on June 3, 2005.

The Company did not pay any cash dividends during the fiscal years ended March 31, 2006 or 2007. The Company currently anticipates that all of its earnings will be retained for expansion of the Company's business, and it does not anticipate paying any cash dividends in the foreseeable future. Any payment of future dividends and the amounts thereof will be dependent upon the Company's earnings, financial requirements, and other factors deemed relevant by the Board of Directors. In addition, the Company's \$110.0 million line of credit facility contains certain covenants which may restrict the Company's ability to pay cash dividends.

**Table of Contents**

There are no Canadian foreign exchange controls or laws that would affect the remittance of dividends or other payments to the Company's non-Canadian resident shareholders. There are no Canadian laws that restrict the export or import of capital, other than the Investment Canada Act (Canada), which requires the notification or review of certain investments by non-Canadians to establish or acquire control of a Canadian business. The Company is not a Canadian business as defined under the Investment Canada Act because it has no place of business in Canada, has no individuals employed in Canada in connection with its business, and has no assets in Canada used in carrying on its business.

Canada and the United States of America are signatories to the Canada-United States Tax Convention Act, 1984 (the Tax Treaty). The Tax Treaty contains provisions governing the tax treatment of interest, dividends, gains and royalties paid to or received by a person residing in the United States. The Tax Treaty also contains provisions to prevent the occurrence of double taxation, essentially by permitting the taxpayer to claim a tax credit for taxes paid in the foreign jurisdiction.

Dividends paid to the Company from its U.S. subsidiaries' current and accumulated earnings and profits will be subject to a U.S. withholding tax of 5%. The gross dividends (i.e., before payment of the withholding tax) must be included in the Company's net income. However, under certain circumstances, the Company may be allowed to deduct the dividends in the calculation of its Canadian taxable income. If the Company has no other foreign (i.e., non-Canadian) non-business income, no relief is available in that case to recover the withholding taxes previously paid.

A 15% Canadian withholding tax applies to dividends paid by the Company to a U.S. shareholder that is an individual. The U.S. shareholder must include the gross amount of the dividends in his net income to be taxed at the regular rates. A foreign tax credit will be available to the extent of the lesser of:

(i) withholding taxes paid (up to a maximum of 15% of certain foreign income from property); and

(ii) the U.S. taxes payable in respect to that foreign income.

Alternatively, an individual can claim the foreign withholding taxes paid as a deduction in the computation of income for tax purposes. If the withholding taxes paid exceed 15% of the foreign income from property, such excess must be deducted in computing net income.

Dividends paid to a corporate U.S. shareholder that owns less than 10% of the Company's voting shares are also subject to a Canadian withholding tax of 15%.

**Table of Contents****Securities Authorized for Issuance Under Equity Compensation Plans**

The following table sets forth certain information, as of March 31, 2007, with respect to compensation plans under which equity securities of the Company were authorized for issuance:

**EQUITY COMPENSATION PLAN INFORMATION**

<b>Plan Category</b>	<b>Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (a)</b>	<b>Weighted Average Exercise Price of Outstanding Options, Warrants and Rights (b)</b>	<b>Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a)) (c)</b>
Equity Compensation Plans Approved by Security Holders	709,250	\$ 2.65	915,000
Equity Compensation Plans Not Approved by Security Holders	None	Not Applicable	None
<b>TOTAL</b>	<b>709,250</b>	<b>\$ 2.65</b>	<b>915,000</b>

**Table of Contents****Item 6. Selected Financial Data**

The following tables present selected consolidated financial data as of and for the years ended March 31, 2007, 2006, 2005, 2004 and 2003. The selected consolidated financial data have been derived from our consolidated financial statements. All historical share and per share amounts have been restated to reflect the effect of the stock split for all periods presented.

You should read the selected consolidated financial data in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our audited consolidated financial statements and notes thereto that are included elsewhere in this Form 10-K.

	Year ended March 31,				
	2007	2006	2005	2004	2003
<b>Statement of Operations Data</b>					
Interest income on finance receivables	<b>\$ 46,590,436</b>	\$ 42,502,615	\$ 32,582,965	\$ 25,236,638	\$ 22,048,535
Sales	<b>118,938</b>	174,055	248,928	263,847	328,340
	<b>46,709,374</b>	42,676,670	32,831,893	25,500,485	22,376,875
Interest expense	<b>5,535,599</b>	4,332,414	3,630,267	3,851,924	3,936,042
Provision for credit losses	<b>3,690,405</b>	3,908,953	2,396,985	2,198,501	2,213,859
Salaries and employee benefits	<b>11,994,082</b>	11,326,909	8,976,912	7,028,267	5,963,038
Other expenses	<b>6,751,713</b>	6,068,099	4,715,026	4,032,132	3,426,354
	<b>27,971,799</b>	25,636,375	19,719,190	17,110,824	15,539,293
Operating income before income taxes	<b>18,737,575</b>	17,040,295	13,112,703	8,389,661	6,837,582
Income tax expense	<b>7,157,816</b>	6,480,806	5,033,008	3,176,983	2,556,188
Net income	<b>\$ 11,579,759</b>	\$ 10,559,489	\$ 8,079,695	\$ 5,212,678	\$ 4,281,394
Earnings per share basic:	<b>\$ 1.17</b>	\$ 1.07	\$ 0.85	\$ 0.69	\$ 0.57
Weighted average shares outstanding	<b>9,929,944</b>	9,873,237	9,462,620	7,570,641	7,506,083
Earnings per share diluted:	<b>\$ 1.13</b>	\$ 1.01	\$ 0.80	\$ 0.64	\$ 0.54
Weighted average shares outstanding	<b>10,283,173</b>	10,474,291	10,082,694	8,128,062	7,948,809

**Table of Contents****Item 6. Selected Financial Data (continued)**

	As of and for the Year ended March 31,				
	2007	2006	2005	2004	2003
<b>Balance Sheet Data</b>					
Total assets	\$ 173,019,248	\$ 149,494,943	\$ 120,815,441	\$ 103,223,452	\$ 90,036,928
Finance receivables, net	164,364,715	140,197,738	113,708,122	97,236,516	86,178,112
Line of credit	94,012,099	82,415,917	65,330,897	67,510,290	60,160,238
Shareholders' equity	69,806,985	58,249,175	46,757,894	27,445,593	22,090,440
<b>Operating Data</b>					
Return on average assets	7.18%	7.81%	7.21%	5.39%	5.09%
Return on average equity	18.08%	20.11%	21.78%	21.05%	21.13%
Gross portfolio yield (1)	27.01%	28.40%	25.20%	22.60%	22.54%
Pre-tax yield (1)	10.89%	11.45%	10.18%	7.55%	7.10%
Total delinquencies over 30 days	2.18%	1.59%	1.46%	1.55%	2.19%
Write-off to liquidation (1)	6.72%	5.44%	6.28%	8.41%	9.32%
Net charge-off percentage (1)	6.30%	4.98%	5.46%	7.26%	8.13%
<b>Automobile Finance Data &amp; Direct Loan Origination</b>					
Contracts purchased/direct loans originated	\$ 128,865,697	\$ 117,293,524	\$ 92,745,349	\$ 77,345,798	\$ 68,076,334
Average discount	8.45%	8.78%	8.78%	8.95%	8.91%
Weighted average contractual rate (1)	23.99%	24.14%	24.15%	24.15%	24.31%
Number of branch locations	47	42	35	29	28

(1) See definitions on page 26

**Table of Contents****Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

The Company is a Canadian holding company incorporated under the laws of British Columbia in 1986. The Company conducts its business activities through two wholly-owned Florida corporations: Nicholas Financial, which purchases and services Contracts, makes direct loans and sells consumer-finance related products; and NDS, which supports and updates certain computer application software. Nicholas Financial accounted for more than 99% of the Company's consolidated revenue for the fiscal years ended March 31, 2007, 2006 and 2005, respectively.

The Company's consolidated revenues increased for the fiscal year ended March 31, 2007 to \$46.7 million as compared to \$42.7 million and \$32.8 million for the fiscal years ended March 31, 2006 and 2005, respectively. The Company's consolidated net income increased for the fiscal year ended March 31, 2007 to \$11.6 million compared to \$10.6 million and \$8.1 million for the fiscal years ended March 31, 2006 and 2005, respectively. The Company's earnings were favorably impacted by a 15% increase in average net finance receivables.

	Fiscal Year ended March 31,		
	2007	2006	2005
<b>Portfolio Summary</b>			
Average finance receivables, net of unearned interest (1) Average Net Finance Receivables (1)	\$ 172,508,750	\$ 149,634,203	\$ 129,292,768
Average indebtedness (2)	\$ 87,392,132	\$ 73,664,722	\$ 63,697,012
Finance revenue (3)	\$ 46,590,436	\$ 42,502,615	\$ 32,582,965
Interest expense	5,535,599	4,332,414	3,630,267
Net finance revenue	\$ 41,054,837	\$ 38,170,201	\$ 28,952,698
Weighted average contractual rate (4)	23.99%	24.14%	24.15%
Average cost of borrowed funds (2)	6.33%	5.88%	5.70%
Gross portfolio yield (5)	27.01%	28.40%	25.20%
Interest expense as a percentage of average finance receivables, net of unearned interest	3.21%	2.89%	2.81%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	2.14%	2.61%	1.85%
Net portfolio yield (5)	21.66%	22.90%	20.54%
Operating expenses as a percentage of average finance receivables, net of unearned interest (6)	10.77%	11.45%	10.36%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	10.89%	11.45%	10.18%
Write-off to liquidation (8)	6.72%	5.44%	6.28%
Net charge-off percentage (9)	6.30%	4.98%	5.46%

**Table of Contents**

- (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 and notes payable-related party. Average cost of borrowed funds represents interest expense as a percentage of average indebtedness.
- (3) Finance revenue does not include revenue generated by NDS.
- (4) Weighted average contractual rate represents the weighted average annual percentage rate (APR) of all Contracts purchased and direct loans originated during the period.
- (5) Gross portfolio yield represents finance revenues as a percentage of average finance receivables, net of unearned interest. Net portfolio yield represents finance revenue minus (a) interest expense and (b) the provision for credit losses as a percentage of average finance receivables, net of unearned interest.
- (6) Operating expenses represent total expenses, less interest expense, the provision for credit losses and operating costs associated with NDS.
- (7) Pre-tax yield represents net portfolio yield minus operating expenses as a percentage of average finance receivables, net of unearned interest.
- (8) Write-off to liquidation percentage is defined as net charge-offs divided by liquidation. Liquidation is defined as beginning receivable balance plus current period purchases minus voids and refinances minus ending receivable balance.
- (9) Net charge-off percentage represents net charge-offs divided by average finance receivables, net of unearned interest, outstanding during the period.

The following tables present certain information regarding the delinquency rates experienced by the Company with respect to Contracts and under its direct loan program:

	At March 31, 2007		At March 31, 2006		At March 31, 2005	
<b>Contracts</b>						
Gross Balance Outstanding	\$ 247,002,051		\$ 214,509,842		\$ 176,758,883	
	Dollar Amount	Percent	Dollar Amount	Percent	Dollar Amount	Percent
<b>Delinquencies</b>						
30 59 days	\$ 4,072,821	1.65%	\$ 2,718,246	1.27%	\$ 1,934,136	1.10%
60 89 days	921,097	0.37%	521,319	0.24%	408,651	0.23%
90 + days	506,433	0.21%	220,664	0.10%	249,547	0.14%
Total Delinquencies	\$ 5,500,351	2.23%	\$ 3,460,229	1.61%	\$ 2,592,334	1.47%
<b>Direct Loans</b>						
Gross Balance Outstanding	\$ 9,990,060		\$ 8,208,542		\$ 5,627,852	
	Dollar Amount	Percent	Dollar Amount	Percent	Dollar Amount	Percent
<b>Delinquencies</b>						
30 59 days	\$ 65,982	0.66%	\$ 59,910	0.73%	\$ 37,520	0.67%
60 89 days	12,024	0.12%	16,258	0.20%	6,945	0.12%
90 + days	21,476	0.22%	10,139	0.12%	23,892	0.42%
Total Delinquencies	\$ 99,482	1.00%	\$ 86,307	1.05%	\$ 68,357	1.21%

## **Table of Contents**

### **Critical Accounting Policy**

The Company's critical accounting policy relates to the allowance for losses on loans. It is based on management's opinion of an amount that is adequate to absorb losses in the existing portfolio. The allowance for credit losses is established through allocations of dealer discount and, for loans acquired prior to April 1, 2005, a portion of unearned income and a provision for loss based on management's evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, specific impaired loans and current economic conditions. Such evaluation, which includes a review of all loans on which full collectibility may not be reasonably assured, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management's estimate of probable credit losses and other factors that warrant recognition in providing for an adequate credit loss allowance.

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

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

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

A dealer discount represents the difference between the finance receivable, net of unearned interest, of a Contract, and the amount of money the Company actually pays for the Contract. The discount negotiated by the Company is a function of the credit quality of the customer and the wholesale value of the vehicle. The automotive dealer accepts these terms by executing a dealer agreement with the Company. The entire amount of discount is related to credit quality and is considered to be part of the credit loss reserve. The Company utilizes a static pool approach to track portfolio performance. A static pool retains an amount equal to 100% of the discount as a reserve for credit losses.

---

**Table of Contents**

Subsequent to the purchase, if the reserve for credit losses is determined to be inadequate for a static pool which is not fully liquidated, then an additional charge to income through the provision is used to reestablish adequate reserves. If a static pool is fully liquidated and has any remaining reserves, the excess discounts are immediately recognized into income and the excess provision is immediately reversed during the period. For static pools not fully liquidated that are determined to have excess discounts, such excess amounts are accreted into income over the remaining life of the static pool. For static pools not fully liquidated that are deemed to have excess reserves, such excess amounts are reversed against provision for credit losses during the period.

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

**Fiscal 2007 compared to Fiscal 2006****Interest and Fee Income on Finance Receivables**

Interest income on finance receivables, predominantly finance charge income, increased 7% to \$46.6 million in fiscal 2007 from \$42.5 million in fiscal 2006. The average finance receivables, net of unearned interest, totaled \$172.5 million for the year ended March 31, 2007, an increase of 15% from \$149.6 million for the year ended March 31, 2006. The primary reason average finance receivables, net of unearned interest increased was the increase in the receivable base of several existing branches and the opening of five additional branch locations. The gross finance receivable balance increased 15% to \$257.0 million at March 31, 2007 from \$222.7 million at March 31, 2006. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased from 28.40% for the fiscal year ended March 31, 2006 to 27.01% for the fiscal year ended March 31, 2007. The net portfolio yield decreased from 22.90% for the fiscal year ended March 31, 2006 to 21.66% for the fiscal year ended March 31, 2007. The gross portfolio yield decreased due to a combination of a change to reflect interest earned on a contractual basis, as opposed to on the basis of expected yield (see discussion under Analysis of Credit Losses below), together with decreases in accretion of discounts due to deterioration in portfolio performance. The net portfolio yield decreased due to the above factors, net of additional provisions for credit losses required for the change in the recognition of interest and the resulting affect on credit loss provisions.

**Computer Software Business**

Sales for the fiscal year ended March 31, 2007 were \$118,938 as compared to \$174,055 for the fiscal year ended March 31, 2006, a decrease of 32%. This decrease was primarily due to lower revenue from the existing customer base during the fiscal year ended March 31, 2007. Cost of sales and operating expenses decreased from \$264,754 for the fiscal year ended March 31, 2006 to \$164,209 for the fiscal year ended March 31, 2007. This decrease was attributed to the decrease in sales for the fiscal year ended March 31, 2007.

**Operating Expenses**

Total expenses, less the provision for credit losses, interest expense and costs associated with NDS, increased to \$18.6 million for the fiscal year ended March 31, 2007 from \$17.1 million for the fiscal year ended March 31, 2006. This increase of 8% was primarily attributable to the additional staffing at several existing branches, increased general operating expenses and the opening of five additional branch offices. Operating expenses as a percentage of average finance receivables, net of unearned interest, decreased from 11.45% for the fiscal year ended March 31, 2006 to 10.77% for the fiscal year ended March 31, 2007.

## **Table of Contents**

### **Interest Expense**

Interest expense increased from \$4.3 million for the fiscal year ended March 31, 2006 as compared to \$5.5 million for the fiscal year ended March 31, 2007. The average indebtedness for the fiscal year ended March 31, 2007 increased to \$87.4 million as compared to \$73.7 million for the fiscal year ended March 31, 2006. The average cost of borrowed funds increased from 5.88% during the fiscal year ended March 31, 2006 to 6.33% during the fiscal year ended March 31, 2007.

### **Analysis of Credit Losses**

As of March 31, 2007, the Company had 774 active static pools. The average pool upon inception consisted of 71 Contracts with aggregate finance receivables, net of unearned interest, of approximately \$638,000.

Prior to April 1, 2005, in situations where, at the date of purchase, the dealer discount was determined to be insufficient to absorb all potential credit losses associated with a static pool, a portion of unearned income associated with the static pool was allocated to the reserve for dealer discounts. For loans purchased prior to April 1, 2005 the Company recognized revenue on the basis of interest expected to be collected, which was the gross contractual interest less amounts allocated to the reserve for dealer discounts.

Effective with loans purchased after March 31, 2005, the Company discontinued the practice of allocating a portion of unearned income to the reserve for dealer discounts. This change was made to reflect the predominate practice in the industry and improve comparability with other companies within the finance industry. Effective with loans purchased after March 31, 2005 the Company began recognizing interest income based upon the contractual rate of the loan. In situations where the discount is determined to be insufficient to absorb all potential losses associated with the static pool, a charge to income is provided into provision for credit losses over the remaining life of the pool.

The change in the practice of allocating a portion of the unearned income to reserves for dealer discounts did not have a significant effect on the periodic net operating results, but rather resulted in differences in the classification of amounts within the statement of income. Both interest income and provisions for credit losses were higher for those pools acquired during the year ended March 31, 2006 than those pools acquired prior to such period. In addition, while this change has not significantly changed the net finance receivables as reported, the components of net finance receivables have changed as unearned interest as a percentage of gross Contracts has increased as a result of the change and will be followed in subsequent periods by increases in the allowance for credit losses.

**Table of Contents**

Certain tabular information and the discussions pertaining to credit losses presented herein and discussion pertaining to interest income above address the change in the methodology. The table below, which is reflective of the change in allocation, presents net finance receivables as a percentage of gross Contracts as of March 31, 2007 and 2006.

	March 31, 2007		March 31, 2006	
	Amount	% of Gross Contracts	Amount	% of Gross Contracts
Finance receivables, gross Contract	\$ 247,002,051	100.00	\$ 214,509,842	100.00
Unearned interest	(69,487,637)	(28.13)	(58,245,316)	(27.15)
Finance receivables, net of unearned interest	177,514,414	71.87	156,264,526	72.85
Dealer discounts	(10,432,175)	(4.22)	(13,629,445)	(6.35)
Allowance for credit losses	(10,206,737)	(4.13)	(8,644,810)	(4.04)
Finance receivables, net	\$ 156,875,502	63.52	\$ 133,990,271	62.46

The following table sets forth a reconciliation of the changes in dealer discounts on Contracts.

	Fiscal Year ended March 31,	
	2007	2006
Balance at beginning of year	\$ 13,629,445	\$ 18,598,147
Discounts acquired on new volume	10,024,971	9,486,606
Losses absorbed	(10,775,038)	(7,574,807)
Recoveries	1,722,580	1,425,967
Dealer discounts accreted	(4,169,783)	(8,306,468)
Balance at end of year	\$ 10,432,175	\$ 13,629,445

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

	Fiscal Year ended March 31,	
	2007	2006
Balance at beginning of year	\$ 8,644,810	\$ 6,448,790
Current period provision	3,347,810	3,651,148
Losses absorbed	(1,785,883)	(1,455,128)
Balance at end of year	\$ 10,206,737	\$ 8,644,810

**Table of Contents**

The following table sets forth a reconciliation of the changes in the allowance for credit losses on direct loans.

	<b>Fiscal Year ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Balance at beginning of year	<b>\$ 293,767</b>	\$ 199,653
Current period provision	<b>279,255</b>	216,837
Losses absorbed	<b>(276,065)</b>	(158,590)
Recoveries	<b>27,731</b>	35,867
<b>Balance at end of year</b>	<b>\$ 324,688</b>	\$ 293,767

Reserves accreted into income for the year ended March 31, 2007 were approximately \$4.2 million as compared to \$8.3 million for the year ended March 31, 2006. Provisions reversed for the year ended March 31, 2007 were \$1.0 million and there were no provisions reversed for the year ended March 31, 2006. The primary reason for the decrease in reserves accreted during the year ended March 31, 2007 as compared to the year ended March 31, 2006 was an increase in the net charge-off percentage from 4.98% to 6.30%. The primary reason for reversal of provisions previously recorded was due to the charge-off performance of static pools originated from April 2005 through September 2005.

The average dealer discount associated with new volume for the years ended March 31, 2007 and 2006 were 8.45% and 8.78%, respectively.

The provision for credit losses decreased from \$3.9 million for the year ended March 31, 2006 to \$3.7 million for the year ended March 31, 2007, largely due to excess reserves from seasoned static pools which have been adjusted during the 2007 fiscal year. The Company's losses as a percentage of liquidation increased from 5.44% for the fiscal year ended March 31, 2006 to 6.72% for the fiscal year ended March 31, 2007. The longer term outlook for portfolio performance will depend on the overall economic conditions, the unemployment rate and the Company's ability to monitor, manage and implement its underwriting philosophy in additional geographic areas as it strives to continue its expansion. The Company does not believe there have been any significant changes in loan concentrations, terms or quality of Contracts purchased during fiscal 2007 that would have contributed to the increase in losses.

Recoveries as a percentage of charge-offs were 15.3% and 18.9% for the fiscal years ended March 31, 2007 and 2006, respectively. The Company believes that as it continues to expand its operations, it will become more difficult to implement its loss recovery model in geographic areas further away from its Corporate headquarters, and as a result the Company will likely experience declining recovery rates over the long term.

## **Table of Contents**

The U.S. unemployment rate has dropped slightly over the past year. The Company believes there is a correlation between the unemployment rate and future portfolio performance. The Company does not expect the U.S. unemployment rate to rise or fall significantly in the foreseeable future. Therefore the Company does not plan on increasing or decreasing reserves based on the current U.S. unemployment rate. The Company also analyzes bankruptcy filings, voluntary repossession rates and the results of internal branch audits to measure the credit quality of its respective branches as other tools to predict future portfolio performance. These indicators have not changed materially in the past year and the Company does not anticipate any change to reserve levels as such.

The delinquency percentage for Contracts more than thirty days past due as of March 31, 2007 increased to 2.23% from 1.61% as of March 31, 2006. The delinquency percentage for direct loans more than thirty days past due as of March 31, 2007 decreased to 1.00% from 1.05% as of March 31, 2006. The Company does not give significant consideration to short-term trends in delinquency when evaluating reserve levels. Delinquency percentages tend to be volatile and are not necessarily an indication of future losses. The Company utilizes a static pool approach to analyzing portfolio performance and looks at specific static pool performance and recent trends as leading indicators to future performance of the portfolio.

## **Income Taxes**

The provision for income taxes increased 11% to approximately \$7.2 million in fiscal year 2007 from approximately \$6.5 million in fiscal year 2006 primarily as a result of higher pretax income. The Company's effective tax rate increased from 38.03% in fiscal 2006 to 38.23% in fiscal 2007.

---

**Table of Contents**

**Fiscal 2006 compared to Fiscal 2005**

**Interest and Fee Income on Finance Receivables**

Interest income on finance receivables, predominantly finance charge income, increased 30% to \$42.5 million in fiscal 2006 from \$32.6 million in fiscal 2005. The average finance receivables, net of unearned interest, totaled \$149.6 million for the year ended March 31, 2006, an increase of 16% from \$129.3 million for the year ended March 31, 2005. The primary reason average finance receivables, net of unearned interest increased was the increase in the receivable base of several existing branches and the opening of seven additional branch locations. The gross finance receivable balance increased 22% to \$222.7 million at March 31, 2006 from \$182.4 million at March 31, 2005. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield increased from 25.20% for the fiscal year ended March 31, 2005 to 28.40% for the fiscal year ended March 31, 2006. The net portfolio yield increased from 20.54% for the fiscal year ended March 31, 2005 to 22.90% for the fiscal year ended March 31, 2006. The gross portfolio yield increased due to a combination of a change to reflect interest earned on a contractual basis, as opposed to on the basis of expected yield (see discussion under Analysis of Credit Losses below), together with increases in accretion of discounts due to improved portfolio performance. The net portfolio yield increased due to the above factors, net of additional provisions for credit losses required for the change in the recognition of interest and the resulting affect on credit loss provisions.

**Computer Software Business**

Sales for the fiscal year ended March 31, 2006 were \$174,055 as compared to \$248,928 for the fiscal year ended March 31, 2005, a decrease of 30%. This decrease was primarily due to lower revenue from the existing customer base during the fiscal year ended March 31, 2006. Cost of sales and operating expenses decreased from \$291,702 for the fiscal year ended March 31, 2005 to \$264,754 for the fiscal year ended March 31, 2006. This decrease was attributed to the decrease in sales for the fiscal year ended March 31, 2006.

**Operating Expenses**

Total expenses, less the provision for credit losses, interest expense and costs associated with NDS, increased to \$17.1 million for the fiscal year ended March 31, 2006 from \$13.4 million for the fiscal year ended March 31, 2005. This increase of 28% was primarily attributable to the additional staffing at several existing branches, increased general operating expenses and the opening of seven additional branch offices. Operating expenses as a percentage of average finance receivables, net of unearned interest, increased from 10.36% for the fiscal year ended March 31, 2005 to 11.45% for the fiscal year ended March 31, 2006.

**Interest Expense**

Interest expense increased from \$3.6 million for the fiscal year ended March 31, 2005 as compared to \$4.3 million for the fiscal year ended March 31, 2006. The average indebtedness for the fiscal year ended March 31, 2006 increased to \$73.7 million as compared to \$63.7 million for the fiscal year ended March 31, 2005. The average cost of borrowed funds increased from 5.70% during the fiscal year ended March 31, 2005 to 5.88% during the fiscal year ended March 31, 2006.

**Analysis of Credit Losses**

As of March 31, 2006, the Company had 679 active static pools. The average pool upon inception consisted of 72 Contracts with aggregate finance receivables, net of unearned interest, of approximately \$617,000.

**Table of Contents**

Prior to the April 1, 2005, in situations where, at the date of purchase, the dealer discount was determined to be insufficient to absorb all potential credit losses associated with a static pool, a portion of unearned income associated with the static pool was allocated to the reserve for dealer discounts. For loans purchased prior to April 1, 2005 the Company recognized revenue on the basis of interest expected to be collected, which was the gross contractual interest less amounts allocated to the reserve for dealer discounts.

Effective with loans purchased after March 31, 2005, the Company discontinued the practice of allocating a portion of unearned income to the reserve for dealer discounts. This change was made to reflect the predominate practice in the industry and improve comparability with other companies within the finance industry. Effective with loans purchased after March 31, 2005 the Company began recognizing interest income based upon the contractual rate of the loan. In situations where, at the date of purchase, the discount is determined to be insufficient to absorb all potential losses associated with the static pool, a charge to income is calculated and amortized into provision for credit losses over the life of the pool.

The change in the practice of allocating a portion of the unearned income to reserves for dealer discounts did not have a significant effect on the periodic net operating results, but rather resulted in differences in the classification of amounts within the statement of income. Both interest income and provisions for credit losses were higher for those pools acquired during the year ended March 31, 2006 than those pools acquired prior to such period. In addition, while this change has not significantly changed the net finance receivables as reported, the components of net finance receivables have changed as unearned interest as a percentage of gross Contracts has increased as a result of the change and will be followed in subsequent periods by increases in the allowance for credit losses.

Certain tabular information and the discussions pertaining to credit losses presented herein and discussion pertaining to interest income above address the change in the methodology. The table below, which is reflective of the change in allocation, presents net finance receivables as a percentage of gross Contracts as of March 31, 2006 and 2005.

	March 31, 2006		March 31, 2005	
	Amount	% of Gross Contracts	Amount	% of Gross Contracts
Finance receivables, gross Contract	\$ 214,509,842	100.00	\$ 176,758,883	100.00
Unearned interest	(58,245,316)	(27.15)	(42,298,636)	(23.93)
Finance receivables, net of unearned interest	156,264,526	72.85	134,460,247	76.07
Dealer discounts	(13,629,445)	(6.35)	(18,598,147)	(10.52)
Allowance for credit losses	(8,644,810)	(4.04)	(6,448,790)	(3.65)
Finance receivables, net	\$ 133,990,271	62.46	\$ 109,413,310	61.90

**Table of Contents**

The following table sets forth a reconciliation of the changes in dealer discounts on Contracts.

	Fiscal Year ended March 31,	
	2006	2005
Balance at beginning of year	\$ 18,598,147	\$ 15,377,582
Discounts acquired on new volume	9,486,606	14,499,829
Losses absorbed	(7,574,807)	(6,869,018)
Recoveries	1,425,967	1,278,081
Dealer discounts accreted	(8,306,468)	(5,688,327)
Balance at end of year	\$ 13,629,445	\$ 18,598,147

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

	Fiscal Year ended March 31,	
	2006	2005
Balance at beginning of year	\$ 6,448,790	\$ 5,787,764
Current period provision	3,651,148	2,238,925
Losses absorbed	(1,455,128)	(1,577,899)
Balance at end of year	\$ 8,644,810	\$ 6,448,790

The following table sets forth a reconciliation of the changes in the allowance for credit losses on direct loans.

	Fiscal Year ended March 31,	
	2006	2005
Balance at beginning of year	\$ 199,653	\$ 184,334
Current period provision	216,837	119,266
Losses absorbed	(158,950)	(136,894)
Recoveries	35,867	32,947
Balance at end of year	\$ 293,767	\$ 199,653

Reserves accreted into income for the year ended March 31, 2006 were approximately \$8.3 million as compared to \$5.7 million for the year ended March 31, 2005. There were no provisions reversed for the year ended March 31, 2006 or March 31, 2005. The primary reasons for the increase in reserves accreted during the year ended March 31, 2006 as compared to the year ended March 31, 2005 was a decrease in the net charge-off percentage from 5.46% to 4.98% and an increase in the size of the portfolio.

The Company experienced a lower net charge-off percentage during the year ended March 31, 2006 as compared to the year ended March 31, 2005. This resulted in static pools having reserves in excess of estimates currently needed to liquidate these pools. The amount and timing of reserves accreted into income is a function of individual static pool performance. The Company has seen improvement in the performance of the portfolio and attributes this decrease to an improvement in overall general economic conditions. The Company is in the process of accreting these excess reserves from these more mature static pools over their remaining life.

**Table of Contents**

The average dealer discount associated with new volume for the years ended March 31, 2006 and 2005 was 8.78%.

The provision for credit losses increased from \$2.4 million for the year ended March 31, 2005 to \$3.9 million for the year ended March 31, 2006 largely due to the change in interest recognition and the effect on provisions for credit losses on loans originated after March 31, 2005. The Company's losses as a percentage of liquidation decreased from 6.28% for the fiscal year ended March 31, 2005 to 5.44% for the fiscal year ended March 31, 2006. The longer term outlook for portfolio performance will depend on the overall economic conditions, the unemployment rate and the Company's ability to monitor, manage and implement its underwriting philosophy in additional geographic areas as it strives to continue its expansion. The Company does not believe there have been any significant changes in loan concentrations, terms or quality of Contracts purchased during fiscal 2006 that would have contributed to the decrease in losses.

Recoveries as a percentage of charge-offs were 18.9% and 17.7% for the fiscal years ended March 31, 2006 and 2005, respectively. The Company believes that as it continues to expand its operations, it will become more difficult to implement its loss recovery model in geographic areas further away from its Corporate headquarters, and as a result the Company will likely experience declining recovery rates over the long term.

**Income Taxes**

The provision for income taxes increased 29% to approximately \$6.5 million in fiscal year 2006 from approximately \$5.0 million in fiscal year 2005 primarily as a result of higher pretax income. The Company's effective tax rate decreased from 38.38% in fiscal 2005 to 38.03% in fiscal 2006.

**Liquidity and Capital Resources**

The Company's cash flows are summarized as follows:

	Fiscal Year ended March 31,		
	2007	2006	2005
Cash provided by (used in):			
Operations	\$ 16,098,666	\$ 15,481,420	\$ 11,168,021
Investing activities - (primarily purchase of Contracts)	(28,394,301)	(31,107,846)	(19,315,970)
Financing activities	12,065,771	16,501,989	8,043,759
Net (decrease) increase in cash	\$ (229,864)	\$ 875,563	\$ (104,190)

The Company's primary use of working capital during fiscal year ended March 31, 2007 was the funding of the purchase of Contracts. The Contracts were financed substantially through borrowings under the Company's \$110.0 million Line. The Line is secured by all of the assets of Nicholas Financial. The Company may borrow the lesser of \$110.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options or at the prime rate. Prime rate based borrowings are generally less than \$5.0 million. As of March 31, 2007, the amount outstanding under the Line was approximately \$94.0 million and the amount available under the Line was approximately \$16.0 million.

**Table of Contents**

The Company has entered into interest rate swap agreements, each of which effectively converts a portion of the Company's floating-rate debt to a fixed-rate, thus reducing the impact of interest rate change on the Company's interest expense. At March 31, 2007, approximately 53% of the Company's borrowings under the Line were subject to interest rate swap agreements. These swap agreements have maturities ranging from April 2, 2007 through September 10, 2010.

The self-liquidating nature of Contracts and other loans enables the Company to assume a higher debt-to-equity ratio than in most businesses. The amount of debt the Company incurs from time to time under these financing mechanisms 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.

In late May and early June 2004, the Company closed the sale of an aggregate of 2,100,000 shares of its common stock at a public offering price of \$5.33 per share. The net proceeds of the offering, approximately \$9.9 million, was used to pay down the Company's Line. In addition, approximately 1,350,000 shares of common stock were sold in the offering by a group of selling shareholders.

The Company's Board of Directors also approved the discontinuation of the payment of an annual cash dividend of \$0.07 per share. The Board determined that it would be advisable, for the foreseeable future, to utilize after-tax profits to pursue continued growth. The Board of Directors will continue to review its dividend policy on an annual basis.

**Impact of Inflation**

The Company is affected by inflation primarily through increased operating costs and expenses including increases in interest rates. Inflationary pressures on operating costs and expenses have been offset by the Company's continued emphasis on stringent operating and cost controls. Management believes that the Company's financial condition has enabled it to negotiate favorable interest rates under its existing Line. No assurances can be given that the Company will be able to continue to do so in the future.

**Contractual Obligations**

The following table summarizes the Company's material obligations as of March 31, 2007.

<b>Years ending March 31,</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Total</b>
Operating leases	\$ 1,099,108	\$ 886,868	\$ 550,029	\$ 81,189	\$ 39,310	\$ 2,656,504
Line of credit		94,012,099				94,012,099
<b>Total</b>	<b>\$ 1,099,108</b>	<b>\$ 94,898,967</b>	<b>\$ 550,029</b>	<b>\$ 81,189</b>	<b>\$ 39,310</b>	<b>\$ 96,668,603</b>

**Table of Contents**

**Item 7A. 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. There was no ineffectiveness associated with the interest rate swap agreements during the year ended March 31, 2007.

**Item 8. Financial Statements and Supplementary Data**

The following financial statements are filed as part of this report (see pages 39-61)

<u>Report of Independent Registered Public Accounting Firm</u>	39
Audited Consolidated Financial Statements	
<u>Consolidated Balance Sheets</u>	40
<u>Consolidated Statements of Income</u>	41
<u>Consolidated Statements of Shareholders' Equity</u>	42
<u>Consolidated Statements of Cash Flows</u>	43
<u>Notes to Consolidated Financial Statements</u>	44

**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

Nicholas Financial, Inc.

We have audited the accompanying consolidated balance sheets of Nicholas Financial, Inc. and subsidiaries as of March 31, 2007 and 2006 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended March 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of March 31, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the three-year period ended March 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 9 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123(R), *Share-based Payment*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated June 14, 2007 expressed an unqualified opinion on management's assessment of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Dixon Hughes PLLC

Atlanta, Georgia

June 14, 2007

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Consolidated Balance Sheets

	March 31,	
	2007	2006
<b>Assets</b>		
Cash	\$ 1,499,193	\$ 1,729,057
Finance receivables, net	164,364,715	140,197,738
Accounts receivable	17,858	11,638
Assets held for resale	887,687	790,224
Prepaid expenses and other assets	578,095	570,723
Property and equipment, net	1,014,698	887,832
Derivatives	659,724	1,601,089
Deferred income taxes	3,997,278	3,706,642
 Total assets	 <b>\$ 173,019,248</b>	 \$ 149,494,943
<b>Liabilities and shareholders equity</b>		
Line of credit	\$ 94,012,099	\$ 82,415,917
Drafts payable	1,291,948	992,171
Accounts payable and accrued expenses	6,155,492	6,064,734
Income taxes payable	225,648	177,557
Deferred revenues	1,527,076	1,595,389
 Total liabilities	 <b>103,212,263</b>	 91,245,768
Commitments and contingencies		
<b>Shareholders equity:</b>		
Preferred stock, no par: 5,000,000 shares authorized;		
none issued and outstanding		
Common stock, no par: 50,000,000 shares authorized; 9,984,281 and 9,912,931 shares issued and outstanding, respectively	16,088,477	15,525,988
Accumulated other comprehensive income	408,237	992,675
Retained earnings	53,310,271	41,730,512
 Total shareholders equity	 <b>69,806,985</b>	 58,249,175
 Total liabilities and shareholders equity	 <b>\$ 173,019,248</b>	 \$ 149,494,943

*See accompanying notes.*

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Consolidated Statements of Income

	Year ended March 31,		
	2007	2006	2005
<b>Revenue:</b>			
Interest and fee income on finance receivables	\$ 46,590,436	\$ 42,502,615	\$ 32,582,965
Sales	118,938	174,055	248,928
	<b>46,709,374</b>	<b>42,676,670</b>	<b>32,831,893</b>
<b>Expenses:</b>			
Cost of sales	17,838	45,230	64,556
Marketing	1,234,588	1,242,337	878,194
Salaries and employee benefits	11,994,082	11,326,909	8,976,912
Administrative	5,136,534	4,445,274	3,550,523
Provision for credit losses	3,690,405	3,908,953	2,396,985
Depreciation	362,754	335,258	221,753
Interest expense	5,535,599	4,332,414	3,630,267
	<b>27,971,799</b>	<b>25,636,375</b>	<b>19,719,190</b>
Operating income before income taxes	18,737,575	17,040,295	13,112,703
Income tax expense	7,157,816	6,480,806	5,033,008
Net income	\$ 11,579,759	\$ 10,559,489	\$ 8,079,695
<b>Earnings per share:</b>			
Basic	\$ 1.17	\$ 1.07	\$ 0.85
Diluted	\$ 1.13	\$ 1.01	\$ 0.80
Dividends declared per share	\$	\$	\$ 0.07

*See accompanying notes.*

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Consolidated Statements of Shareholders' Equity

	Common Stock		Accumulated Other Comprehensive	Retained	Total Shareholders
	Shares	Amount	Income (Loss)	Earnings	Equity
Balance at March 31, 2004	7,627,932	\$ 4,766,150	\$ (1,065,342)	\$ 23,744,785	\$ 27,445,593
Issuance of common stock under stock options	112,599	155,172			155,172
Issuance of common stock	2,100,000	10,416,000			10,416,000
Offering costs		(518,670)			(518,670)
Dividends paid				(653,457)	(653,457)
Income tax benefit on exercise of non-qualified stock options		309,270			309,270
Net income				8,079,695	8,079,695
Mark to market-interest rate swaps			1,524,291		1,524,291
<b>Balance at March 31, 2005</b>	<b>9,840,531</b>	<b>15,127,922</b>	<b>458,949</b>	<b>31,171,023</b>	<b>46,757,894</b>
Issuance of common stock under stock option	72,400	115,700			115,700
Income tax benefit on exercise of non-qualified stock options		282,366			282,366
Net income				10,559,489	10,559,489
Mark to market-interest rate swaps			533,726		533,726
<b>Balance at March 31, 2006</b>	<b>9,912,931</b>	<b>15,525,988</b>	<b>992,675</b>	<b>41,730,512</b>	<b>58,249,175</b>
Issuance of common stock under stock options	<b>26,350</b>	<b>65,826</b>			<b>65,826</b>
Issuance of restricted share awards	<b>45,000</b>				
Income tax benefit on exercise of non-qualified stock options		<b>103,987</b>			<b>103,987</b>
Share-based compensation		<b>392,676</b>			<b>392,676</b>
Net income				<b>11,579,759</b>	<b>11,579,759</b>
Mark to market-interest rate swaps			<b>(584,438)</b>		<b>(584,438)</b>
<b>Balance at March 31, 2007</b>	<b>9,984,281</b>	<b>\$ 16,088,477</b>	<b>\$ 408,237</b>	<b>\$ 53,310,271</b>	<b>\$ 69,806,985</b>

See accompanying notes.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Consolidated Statements of Cash Flows

	2007	Year ended March 31, 2006	2005
<b>Cash flows from operating activities:</b>			
Net income	\$ 11,579,759	\$ 10,559,489	\$ 8,079,695
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	362,754	335,258	221,753
Gain on sale of property and equipment	(50,163)	(10,560)	(9,400)
Provision for credit losses	3,690,405	3,908,953	2,396,985
Deferred income taxes	66,291	(334,458)	(1,272,447)
Share-based compensation	392,676		
Changes in operating assets and liabilities:			
Accounts receivable	(6,220)	1,211	(926)
Prepaid expenses and other assets	(7,372)	(62,771)	(37,476)
Accounts payable and accrued expenses	90,758	1,211,947	1,087,743
Income taxes payable	48,091	(363,342)	415,281
Deferred revenues	(68,313)	235,693	286,813
Net cash provided by operating activities	16,098,666	15,481,420	11,168,021
<b>Cash flows from investing activities:</b>			
Purchase and origination of finance contracts	(112,866,748)	(104,824,762)	(82,630,379)
Principal payments received	85,009,367	74,426,193	63,761,788
Increase in assets held for resale	(97,463)	(259,994)	(37,341)
Purchase of property and equipment	(515,908)	(487,283)	(419,438)
Proceed from sale of property and equipment	76,451	38,000	9,400
Net cash used in investing activities	(28,394,301)	(31,107,846)	(19,315,970)
<b>Cash flows from financing activities:</b>			
(Repayment) issuance of notes payable related party		(1,000,000)	318,470
Net proceeds (repayment) from line of credit	11,596,182	17,085,020	(2,179,393)
Increase in drafts payable	299,777	18,903	62,167
Payment of dividends			(653,457)
Proceeds from exercise of stock options and income tax benefit related thereto	169,812	398,066	464,442
Proceeds from issuance of common stock			10,416,000
Payment of offering costs			(384,470)
Net cash provided by financing activities	12,065,771	16,501,989	8,043,759
Net (decrease) increase in cash	(229,864)	875,563	(104,190)
Cash, beginning of year	1,729,057	853,494	957,684
Cash, end of year	\$ 1,499,193	\$ 1,729,057	\$ 853,494

*See accompanying notes.*

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

**1. Organization**

Nicholas Financial, Inc. ( Nicholas Financial Canada ) is a Canadian holding company incorporated under the laws of British Columbia with two wholly-owned United States subsidiaries, Nicholas Data Services, Inc. (NDS) and Nicholas Financial, Inc. (NFI). NDS is engaged principally in the development, marketing and support of computer application software. NFI is engaged principally in providing installment sales financing. Both NDS and NFI are based in Florida, U.S.A. The accompanying consolidated financial statements are stated in U.S. dollars and are presented in accordance with accounting principles generally accepted in the United States.

**2. Summary of Significant Accounting Policies**

**Consolidation**

The consolidated financial statements include the accounts of Nicholas Financial Canada and its wholly owned subsidiaries, NDS and NFI, collectively referred to as the Company. All intercompany transactions and balances have been eliminated.

**Use of Estimates**

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The most significant of these estimates relates to the determination of the allowance for credit losses and related reserves. Actual results could differ from those estimates.

**Finance Receivables**

Finance receivables purchased and originated are recorded at cost.

**Allowance for Loan Losses**

The allowance for loan losses is increased by charges against earnings and decreased by charge-offs (net of recoveries). In addition to the allowance for loan losses, a reserve for credit losses has been established using dealer discounts to absorb potential credit losses. To the extent actual credit losses exceed these reserves, a bad debt provision is recorded; and to the extent credit losses are less than the reserve, the reserve is accreted into income over the remaining estimated life of the static pool. The Company aggregates Contracts into static pools consisting of Contracts purchased during a three-month period for each branch location. Management's periodic evaluation of the adequacy of the allowance is based on the Company's past loan experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral, and current economic conditions. As conditions change, the Company's level of provisioning and/or allowance may change as well.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Assets Held for Resale**

Assets held for resale are stated at net realizable value and consist primarily of automobiles that have been repossessed by the Company and are awaiting final disposition. Costs associated with repossession, transport and auction preparation expenses are charges reported under operating expenses in the period in which they were incurred. The Company maintains full responsibility for repossessions

**Property and Equipment**

Property and equipment are recorded at cost, net of accumulated depreciation. Expenditures for repairs and maintenance are charged to expense as incurred. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the assets as follows:

Automobiles	3 years
Equipment	5 years
Furniture and fixtures	7 years
Leasehold improvements	Lesser of lease term or useful life (generally 6 - 7 years)

**Drafts Payable**

Drafts payable represent checks disbursed for loan purchases which have not yet been funded through the line of credit. Amounts generally clear within two business days of period end and are then added to the line of credit.

**Income Taxes**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the enactment date.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Revenue Recognition**

Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan is contractually delinquent for 60 days or more or the collateral is repossessed, whichever is earlier. As of March 31, 2007, 2006 and 2005 the amount of gross finance receivables not accruing interest was approximately \$1,461,000, \$768,000 and \$689,000, 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 & health insurance, credit life insurance and forced placed automobile insurance. These commissions are amortized over the life of the contract using the effective annual interest method.

The Company attributes its entire dealer discount to a reserve for credit losses. The Company's net fees charged for processing a loan are recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method. After the analysis of purchase date accounting is complete, any uncollectable amounts would be contemplated in estimating the allowance for loan losses.

Revenues resulting from the sale of hardware and software are recognized when persuasive evidence of an agreement exists, delivery of the products has occurred, no significant Company obligations with regard to implementation remain, the fee is fixed or determinable and collectibility is probable. If the fee due from the customer is not fixed or determinable, revenue is recognized as payments become due from the customer. If collectibility is not considered probable, revenue is recognized when the fee is collected. Arrangements that included software services are evaluated to determine whether those services are essential to the functionality of other elements of the arrangement. When software services are considered essential, revenue under the arrangement is recognized using contract accounting. When software services are not considered essential, the revenue related to the software services is recognized as the services are performed. The unamortized amounts are included in the caption of deferred revenues on the consolidated balance sheets.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)****Earnings Per Share**

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

	Year ended March 31,		
	2007	2006	2005
Numerator for earnings per share net income	\$ 11,579,759	\$ 10,559,489	\$ 8,079,695
Denominator:			
Denominator for basic earnings per share weighted average shares	9,929,944	9,873,237	9,462,620
Effect of dilutive securities:			
Stock options and other share awards	359,585	601,054	620,074
Denominator for diluted earnings per share	10,289,173	10,474,291	10,082,694
Earnings per share basic	\$ 1.17	\$ 1.07	\$ 0.85
Earnings per share diluted	\$ 1.13	\$ 1.01	\$ 0.80

**Share-Based Payments**

Effective April 1, 2006, the Company adopted Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 123 (Revised 2004), Share-Based Payment ( SFAS No. 123(R) ). SFAS No. 123(R) replaces SFAS No. 123, supersedes Accounting Principles Board (APB) No. 25 and related interpretations. SFAS No. 123(R) also amends SFAS No. 95 Statement of Cash Flows, to require that excess tax benefits be reported as financing cash inflows, rather than as a reduction of taxes paid, which is included within operating cash flows . SFAS No. 123(R) requires recognition of the cost of employee services received in exchange for an award of equity instruments in the consolidated financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). SFAS No. 123(R) also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award. The Company adopted SFAS No. 123(R) using the modified prospective application. Accordingly, prior period amounts have not been restated. Under this application, the Company is required to record compensation expense for all awards granted after the date of adoption and for the unvested portion of previously granted awards that remain outstanding at the date of adoption. Prior to the adoption of SFAS No. 123(R), the Company used the intrinsic value method as prescribed by APB No. 25 and thus recognized no compensation expense for options granted with exercise prices equal to the fair market value of the Company s common stock on the date of grant.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

The Company estimates the fair market value of each option award using the Black-Scholes option pricing model. The risk-free interest rate is based upon a U.S. Treasury instrument with a life that is similar to the expected term of the options. Expected volatility is based upon the historical volatility for the previous period equal to the expected term of the options. The expected term is based upon the average life of previously issued options. The expected dividend yield is based upon the current yield on date of grant.

In accordance with FASB Staff Position No. 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards . The Company elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC pool ) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R).

**Financial Instruments**

The Company's financial instruments consist of finance receivables, accounts receivable, line of credit and accounts payable. For each of these financial instruments, the carrying value approximates its fair value.

The Company's financial instruments that are exposed to concentrations of credit risk are primarily finance receivables and cash. The Company operates in eleven states through its forty-seven branch locations. Florida represents 49% of the finance receivables total as of March 31, 2007. Ohio and North Carolina each represent 11% and Georgia represents 9% of the finance receivables total as of March 31, 2007. Of the remaining seven states, no one state represents more than 7% of the total finance receivables. The Company provides credit during the normal course of business and performs ongoing credit evaluations of its customers. The Company maintains reserves for potential credit losses which, when realized, have been within the range of management's expectations. The Company perfects a primary security interest in all vehicles financed as a form of collateral. From time to time the Company maintains deposits with banks which exceed the \$100,000 Federal Deposit Insurance Corporation insured limit. Historically, the Company has not experienced any loss of cash due to such concentration of credit risk.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

**Derivatives**

Derivatives are accounted for under SFAS 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities. SFAS No. 133 requires the recognition of all derivative instruments as either assets or liabilities in the consolidated balance sheet at fair value. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the hedging instrument, based on the exposure being hedged, as either a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. The Company does not use derivative instruments for speculative purposes.

**Accumulated Other Comprehensive Income (Loss)**

Accumulated other comprehensive income (loss) is composed entirely of the fair value of cash flow hedges, net of the related tax effect.

**Statement of Cash Flows**

Cash paid for income taxes for the years ended March 31, 2007, 2006 and 2005 was approximately \$6,939,000, \$6,901,000 and \$5,581,000, respectively. Cash paid for interest for the years ended March 31, 2007, 2006 and 2005 was approximately \$5,409,000, \$4,242,000 and \$3,637,000, respectively.

**Recent Accounting Pronouncements**

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. While the Company is still evaluating FIN 48 and the potential impact, it does not currently believe it will have a material impact on the consolidated financial statements.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

In September 2006, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements* , ( SAB 108 ). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC has stated that registrants should quantify errors using both a balance sheet and income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. On March 31, 2007, the Company adopted SAB 108. The Company does not have any prior year misstatements deemed material under the provisions of SAB 108 and therefore the adoption of SAB 108 did not impact the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* . This statement enhances existing guidance for measuring assets and liabilities using fair value. Prior to the issuance of SFAS No. 157, guidance for applying fair value was incorporated in several accounting pronouncements. This statement provides a single definition of fair value, together with a framework for measuring it, and requires additional disclosure about the use of fair value to measure assets and liabilities. SFAS No. 157 also emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. Under this statement, fair value measurements are disclosed by level within that hierarchy. While SFAS No. 157 does not add any new fair value measurements, it does change current practice. Changes to practice include: (1) a requirement for an entity to include its own credit standing in the measurement of its liabilities; (2) a modification of the transaction price presumption; (3) a prohibition on the use of block discounts when valuing large blocks of securities for broker-dealers and investment companies; and (4) a requirement to adjust the value of restricted stock for the effect of the restriction even if the restriction lapses within one year. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company is currently evaluating SFAS No. 157 and the potential impact, if any, that adoption will have on the consolidated financial statements.

In September 2006, the FASB Emerging Issues Task Force (EITF) reached a consensus on Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements* and EITF Issue 06-5, *Accounting for Purchases of Life Insurance - Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4* . Both Issues provide guidance on the recognition of company-paid life insurance protecting against the loss of key employees. These issues are effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating EITF 06-4 or EITF 06-5 and the potential impact that adoption will have on the consolidated financial statements.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**2. Summary of Significant Accounting Policies (continued)**

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. Including an amendment of SFAS No. 115. SFAS No. 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses on that item shall be reported in current earnings at each subsequent reporting date. SFAS No. 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted. The Company is currently evaluating SFAS No. 159 and the potential impact, if adopted, on the consolidated financial statements.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA, and the SEC did not and are not believed by the Company to have a material impact on the Company's present or future consolidated financial statements.

**3. Finance Receivables**

The Company purchases individual installment loan contracts from new and used automobile dealers in its markets. There is no relationship between the Company and the dealer with respect to a given contract once the assignment of that contract is complete. The dealer has no vested interest in the performance of any installment contract the Company purchases.

The Company charges-off receivables when an individual account has become more than 120 days contractually delinquent. In the event of repossession the charge-off will occur in the month in which the vehicle was repossessed.

Consumer automobile finance installment contracts are included in finance receivables and are detailed as follows as of March 31:

	2007	2006	2005
Indirect finance receivables, gross contract	<b>\$ 247,002,051</b>	\$ 214,509,842	\$ 176,758,883
Unearned interest	<b>(69,487,637)</b>	(58,245,316)	(42,298,636)
Indirect finance receivables, net of unearned interest	<b>177,514,414</b>	156,264,526	134,460,247
Dealer discounts	<b>(10,432,175)</b>	(13,629,445)	(18,598,147)
Allowance for credit losses	<b>(10,206,737)</b>	(8,644,810)	(6,448,790)
Indirect finance receivables, net	<b>\$ 156,875,502</b>	\$ 133,990,271	\$ 109,413,310

**Table of Contents**

## Nicholas Financial, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued)

**3. Finance Receivables (continued)**

The terms of the indirect finance receivables range from 12 to 72 months and bear a weighted average effective interest rate of 24% for March 31, 2007 and 2006.

Direct consumer loans are also included in finance receivables and are detailed as follows for the years ended March 31:

	2007	2006	2005
Direct finance receivables, gross contract	\$ 9,990,060	\$ 8,208,542	\$ 5,627,852
Unearned interest	(2,176,159)	(1,707,308)	(1,133,387)
Direct finance receivables, net of unearned interest	7,813,901	6,501,234	4,494,465
Allowance for credit losses	(324,688)	(293,767)	(199,653)
Direct finance receivables, net	\$ 7,489,213	\$ 6,207,467	\$ 4,294,812

The terms of the direct finance receivables range from 6 to 48 months and bear a weighted average effective interest rate of 24% for March 31, 2007 and 2006.

The following table sets forth a reconciliation of the changes in dealer discounts for the years ended March 31:

	2007	2006	2005
Balance at beginning of year	\$ 13,629,445	\$ 18,598,147	\$ 15,377,582
Discounts acquired on new volume	10,024,971	9,486,606	14,499,829
Losses absorbed	(10,775,038)	(7,574,807)	(6,869,018)
Recoveries	1,722,580	1,425,967	1,278,081
Dealer discounts accreted	(4,169,783)	(8,306,468)	(5,688,327)
Balance at end of year	\$ 10,432,175	\$ 13,629,445	\$ 18,598,147

The following table sets forth a reconciliation of the changes in the allowance for credit losses on consumer automobile finance installment contracts for the years ended March 31:

	2007	2006	2005
Balance at beginning of year	\$ 8,644,810	\$ 6,448,790	\$ 5,787,764
Current year provision	3,347,810	3,651,148	2,238,925
Losses absorbed	(1,785,883)	(1,455,128)	(1,577,899)
Balance at end of year	\$ 10,206,737	\$ 8,644,810	\$ 6,448,790



**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**3. Finance Receivables (continued)**

The following table sets forth a reconciliation of the changes in the allowance for credit losses on direct loans for the years ended March 31:

	2007	2006	2005
Balance at beginning of year	\$ 293,767	\$ 199,653	\$ 184,334
Current year provision	279,255	216,837	119,266
Losses absorbed	(276,065)	(158,590)	(136,894)
Recoveries	27,731	35,867	32,947
Balance at end of year	\$ 324,688	\$ 293,767	\$ 199,653

**4. Property and Equipment**

Property and equipment as of March 31, 2007 and 2006 is summarized as follows:

	Cost	Accumulated Depreciation	Net Book Value
<b>2007</b>			
Automobiles	\$ 551,862	\$ 305,467	\$ 246,395
Equipment	501,811	298,517	203,294
Furniture and fixtures	414,187	229,169	185,018
Leasehold improvements	782,063	402,072	379,991
	\$ 2,249,923	\$ 1,235,225	\$ 1,014,698
<b>2006</b>			
Automobiles	\$ 561,774	\$ 299,612	\$ 262,162
Equipment	463,222	265,645	197,577
Furniture and fixtures	387,710	210,298	177,412
Leasehold improvements	564,275	313,594	250,681
	\$ 1,976,981	\$ 1,089,149	\$ 887,832

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**5. Line of Credit**

The Company has a \$110,000,000 line of credit facility (the Line) which expires on November 30, 2008. The Company may borrow the lesser of the \$110,000,000 or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options or at the prime rate. Prime rate based borrowings are generally less than \$5,000,000. Pledged as collateral for this credit facility are all of the assets of the Company. As of March 31, 2007 the outstanding amount of the credit facility was approximately \$94,000,000 and the amount available under the line of credit was approximately \$16,000,000. The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends require consent in writing by the agent and majority lenders under the facility. As of March 31, 2007, the Company was in full compliance with all debt covenants.

**6. Notes Payable Related Party**

During 2005 and the majority of 2006, the Company had unsecured notes payable to the President and Chief Executive Officer. On March 9, 2006 the notes were called and the principal balance of the note of \$600,000 and remaining interest due was paid in full. For fiscal year 2006, the notes had a variable interest rate equal to the average cost of borrowed funds for the Company plus twenty-five basis points (6.10% at March 9, 2006). For fiscal year 2005, the notes had an average interest rate of 5.94%.

The Company incurred interest expense on the above notes of approximately \$37,000 and \$60,000 for the years ended March 31, 2006 and 2005, respectively.

**7. Derivatives and Hedging**

The Company utilizes interest rate swap agreements to manage interest rate exposure. The swaps effectively convert a portion of the Company's floating rate debt to a fixed rate, more closely matching the interest rate characteristics of the Company's finance receivables. At March 31, 2007, \$50,000,000 of the Company's borrowings have been designated as the hedged items to interest rate swap agreements which are detailed as follows:

Date Entered	Effective Date	Notional Amount	Fixed Rate	
			of Interest	Maturity Date
January 6, 2003	April 2, 2003	10,000,000	3.35%	April 2, 2007
February 26, 2003	May 17, 2004	10,000,000	3.91%	May 19, 2008
March 11, 2004	October 5, 2004	10,000,000	3.64%	October 5, 2009
January 18, 2005	July 2, 2005	10,000,000	4.38%	July 2, 2010
September 13, 2005	September 13, 2005	10,000,000	4.46%	September 10, 2010

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**7. Derivatives and Hedging (continued)**

For derivative instruments that are designated and qualify as a cash flow hedge (i.e., hedging the exposure to variability in expected future cash flows that is attributable to a particular risk, such as interest rate risk), the effective portion of the gain or loss on the derivative instrument is reported as a component of comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of the future cash flows of the hedged item, if any, is recognized in current earnings during the period of change.

Each swap agreement has identical terms to the critical terms of the hedged item and meets each condition in SFAS No.133 for utilization of the short-cut method to assess the effectiveness of the swap agreement in hedging the variability of interest payments on the floating rate borrowings under the Line. The short-cut method presumes that there is no hedge ineffectiveness if all such applicable conditions are met and the critical terms of the hedge and the hedged item do not change. During the life of each hedge, the critical terms of the hedge and the hedged item did not change. Accordingly, the Company did not have any gain or loss from hedge ineffectiveness.

The Company records net gains and losses from the swap agreements in the caption of interest expense in the consolidated statements of income. Under the swap agreements, the Company received an average variable rate of 5.24%, 3.83% and 1.79% and paid an average fixed rate of 3.90%, 3.75% and 3.71% for the years ended March 31, 2007, 2006 and 2005, respectively. The interest rate swaps are recorded at fair value, approximately \$660,000 and \$1,601,000 as of March 31, 2007 and 2006, respectively, in the caption derivatives on the balance sheet. Accumulated other comprehensive income at March 31, 2007 and 2006 of approximately \$408,000 and \$993,000, respectively, represents the after-tax effect of the derivative gains.

The following table reconciles net income with comprehensive income for the years ended March 31, 2007, 2006 and 2005.

	2007	2006	2005
Net income	<b>\$ 11,579,759</b>	\$ 10,559,489	\$ 8,079,695
Mark to market interest rate swaps, net of tax (benefit) expense of (\$356,927), \$327,140 and \$927,325, respectively	<b>(584,438)</b>	533,726	1,524,291
Comprehensive income	<b>\$ 10,995,321</b>	\$ 11,093,215	\$ 9,603,986

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**8. Income Taxes**

The provision for income taxes consists of the following for the years ended March 31:

	2007	2006	2005
Current:			
Federal	\$ 6,121,286	\$ 5,898,010	\$ 5,372,912
State	970,239	917,254	932,543
Total current	7,091,525	6,815,264	6,305,455
Deferred:			
Federal	57,203	(289,444)	(1,084,260)
State	9,088	(45,014)	(188,187)
Total deferred	66,291	(334,458)	(1,272,447)
Income tax expense	\$ 7,157,816	\$ 6,480,806	\$ 5,033,008

The net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes are reflected in deferred income taxes. Significant components of the Company's deferred tax assets consist of the following as of March 31:

	2007	2006
Allowance for credit losses not currently deductible for tax purposes	\$ 3,938,060	\$ 4,304,429
Derivatives	(251,487)	(608,414)
Other items	310,705	10,627
	\$ 3,997,278	\$ 3,706,642

The provision for income taxes reflects an effective U.S tax rate, which differs from the corporate tax rate for the following reasons:

	2007	2006	2005
Provision for income taxes at federal statutory rate	\$ 6,558,151	\$ 5,930,468	\$ 4,458,319
Increase resulting from:			
State income taxes, net of federal benefit	636,562	568,703	482,986
Other	(36,897)	(18,365)	91,703
	\$ 7,157,816	\$ 6,480,806	\$ 5,033,008



**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Share-Based Payments**

The Company has share awards outstanding under three share-based compensation plans (the Equity Plans). The Company believes that such awards better align the interests of its employees with those of its shareholders. Under the shareholder-approved 1998 Employee Stock Option Plan and Non-Employee Director Stock Option Plan (collectively the 1998 Plans) the Board of Directors was authorized to grant option awards for up to 1,410,000 common shares to employees and directors. On August 9, 2006 the Company's shareholders approved the Nicholas Financial, Inc. Equity Incentive Plan (the 2006 Plan) for employees and non-employee directors. Under the 2006 Plan the Board of Directors is authorized to grant total share awards for up to 975,000 common shares. The 2006 Plan replaced the 1998 Plans; accordingly no additional option awards may be granted under the 1998 Plans. In addition to option awards, the 2006 Plan provides for restricted stock and performance share awards.

Option awards previously granted to employees and directors under the 1998 Plans generally vest ratably based on service over a five and three-year period, respectively and generally have a contractual term of ten years. Vesting and contractual terms for option awards under the 2006 Plan are essentially the same as those of the 1998 Plans. Restricted stock awards generally cliff vest over a three-year period based on service conditions. The vesting of performance share awards is contingent upon the attainment of company-wide performance goals including annual revenue growth and operating income targets. There are no post-vesting restrictions for share awards.

The Company funds share awards from authorized but unissued shares and does not purchase shares to fulfill the obligations of the plans. Dividends, if any, are not paid on unvested performance shares or unexercised options, but are paid on unvested restricted stock awards.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions:

	<b>Year ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Risk-free interest rate	4.02%	3.90%
Weighted average expected remaining term	6 years	5 years
Expected volatility	34%	32%
Expected dividend yield	0.00%	1.10%

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Share-Based Payments (continued)**

A summary of option activity under the Equity Plans as of March 31, 2007, and changes during the year are presented below.

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2006	756,200	\$ 2.78		
Granted		\$		
Exercised	(26,350)	\$ 2.50		
Forfeited	(20,600)	\$ 7.42		
Outstanding at March 31, 2007	709,250	\$ 2.65	3.35	\$ 6,034,034
Exercisable at March 31, 2007	627,100	\$ 2.03	2.82	\$ 5,724,432

The Company did not grant any option awards during the year ended March 31, 2007. The Company granted 48,000 option awards with grant date fair values of \$4.83 and \$2.16 during the years ended March 31, 2006 and 2005, respectively. The total intrinsic value of options exercised during the years ended March 31, 2007, 2006 and 2005 was approximately \$273,000, \$743,000 and \$814,000 respectively.

During the year ended March 31, 2007, 26,350 options were exercised at exercise prices ranging from \$1.13 to \$10.35 per share. During the same period 20,600 options were forfeited at exercise prices ranging from \$2.20 to \$10.35 per share.

Cash received from options exercised during the years ended March 31, 2007, 2006 and 2005 totaled approximately \$66,000, \$116,000 and \$155,000 respectively. Related income tax benefits during the same periods totaled approximately \$104,000, \$282,000 and \$309,000 respectively. Such amounts are included in proceeds from exercise of stock options and income tax benefit related thereto under cash flows from financing activities in the consolidated statements of cash flows.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Share-Based Payments (continued)**

A summary of the status of the Company's non-vested options under the Equity Plans as of March 31, 2007, and changes during the year then ended is presented below.

		Weighted Average Grant Date
<b>Options</b>	<b>Shares</b>	<b>Fair Value</b>
Non-vested at March 31, 2006	151,850	\$ 2.80
Granted		\$
Vested	(49,100)	\$ 2.16
Forfeited	(20,600)	\$ 3.18
Non-vested at March 31, 2007	82,150	\$ 3.08

As of March 31, 2007, there was \$155,000 of total unrecognized compensation cost related to options granted under the Plan. That cost is expected to be recognized over a weighted-average period of approximately 2 years.

A summary of the status of the Company's non-vested restricted and performance shares under the Equity Plans as of March 31, 2007, and changes during the year then ended is presented below.

		Weighted Average Grant Date	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
<b>Restricted and Performance Share Awards</b>	<b>Shares</b>	<b>Fair Value</b>		
Nonvested at March 31, 2006		\$		
Granted	60,000	\$ 12.93		
Vested	(15,000)	\$ 13.95		
Forfeited		\$		
Nonvested at March 31, 2007	45,000	\$ 12.59	2.39	\$ 502,200

The Company awarded 45,000 restricted shares with a weighted average grant date fair value of \$12.59 and 15,000 performance shares with a weighted average grant date fair value \$13.95 during the year ended March 31, 2007.

## Edgar Filing: NICHOLAS FINANCIAL INC - Form 10-K

As of March 31, 2007, there was \$470,000 of total unrecognized compensation cost related to non-vested restricted and performance share awards granted under the Equity Plan. That cost is expected to be recognized over a weighted-average period of approximately 2 years. The total fair value of shares vested during the year was \$167,000.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**9. Share-Based Payments (continued)**

For purposes of disclosure pursuant to SFAS No. 123 and for recognition pursuant to SFAS No. 123(R) the estimated fair value of share awards is amortized over the awards requisite service period (the vesting period) using the straight line method. The adoption of SFAS No. 123(R) and its fair value compensation cost recognition provisions are different from the non-recognition provisions under SFAS No. 123 and the intrinsic value method for compensation cost allowed by APB No. 25. For the year ended March 31, 2007 total compensation cost for share-based payments recognized in income and the tax benefit related thereto were approximately \$393,000 and \$150,000, respectively. The adoption of SFAS No. 123(R) decreased reported amounts as follows for the year ended March 31, 2007.

Operating income before income taxes	\$ (393,000)
Net income	\$ (243,000)
Earnings per share:	
Basic	\$ (0.02)
Diluted	\$ (0.02)

The following table illustrates the effect on net income and earning per share if the Company had applied the fair value recognition provision of SFAS No. 123(R) to options granted under the plans for the years ended March 31, 2006 and 2005. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes option pricing model and amortized to expense over the awards vesting period.

	Year ended March 31,	
	2006	2005
Reported net income	\$ 10,559,489	\$ 8,079,695
Stock based employee compensation cost under the fair value method, net of tax	78,977	62,496
Pro forma net income	\$ 10,480,512	\$ 8,017,199
Reported basic earnings per share	\$ 1.07	\$ 0.85
Pro forma basic earnings per share	\$ 1.06	\$ 0.85
Reported diluted earnings per share	\$ 1.01	\$ 0.80
Pro forma diluted earnings per share	\$ 1.00	\$ 0.80

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**10. Issuance of Common Stock**

In late May and early June 2004, the Company closed the sale of 2,100,000 shares of its common stock at a public offering price of \$5.33 per share. The net proceeds of the offerings, approximately \$9,897,000 million, were used to pay down the Company's Line. In addition, approximately 1,350,000 shares of common stock were sold in the offering by a group of selling shareholders.

**11. Employee Benefit Plans**

The Company has a 401(k) retirement plan under which all employees are eligible to participate. Employee contributions are voluntary and subject to Internal Revenue Service limitations. The Company matches, based on annually determined factors, employee contributions provided the employee completes certain levels of service annually. For the years ended March 31, 2007, 2006 and 2005, the Company recorded expenses of approximately \$105,000, \$187,000 and \$83,000, respectively, related to this plan.

**12. Commitments and Contingencies**

The Company leases corporate and branch offices under operating lease agreements which provide for annual minimum rental payments as follows:

<b>Year ending March 31:</b>	
2008	\$ 1,099,108
2009	886,868
2010	550,029
2011	81,189
2012	39,310
	\$ 2,656,504

Rent expense for the years ended March 31, 2007, 2006 and 2005 was approximately \$1,194,000, \$1,021,000 and \$815,000, respectively. The Company recognizes rent expense on a straight-line basis over the term of the lease, taking into account, when applicable, lessor incentives for tenant improvements, periods where no rent payment is required and escalations in rent payments over the term of the lease.

The Company 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, in the opinion of management, would have a material adverse affect on the Company's financial position.

**Table of Contents**

Nicholas Financial, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)

**13. Quarterly Results of Operations (Unaudited)**

	First Quarter	Year ended March 31, 2007		
		Second Quarter	Third Quarter	Fourth Quarter
Total revenue	\$ 11,328,874	\$ 11,606,734	\$ 11,730,229	\$ 12,043,537
Interest expense	1,260,203	1,362,691	1,451,647	1,461,058
Provision for credit losses	810,002	852,451	1,193,778	834,174
Non-interest expense	4,356,483	4,910,131	4,605,273	4,873,908
Operating income before income taxes	4,902,186	4,481,461	4,479,531	4,874,397
Income tax expense	1,872,743	1,713,037	1,709,737	1,862,299
Net income	\$ 3,029,443	\$ 2,768,424	\$ 2,769,794	\$ 3,012,098
Earnings per share:				
Basic	\$ 0.31	\$ 0.28	\$ 0.28	\$ 0.30
Diluted	\$ 0.29	\$ 0.27	\$ 0.27	\$ 0.29

	First Quarter	Year ended March 31, 2006		
		Second Quarter	Third Quarter	Fourth Quarter
Total revenue	\$ 9,160,391	\$ 10,238,720	\$ 11,107,248	\$ 12,170,311
Interest expense	980,553	1,058,479	1,122,358	1,171,024
Provision for credit losses	428,025	832,009	1,172,108	1,476,811
Non-interest expense	3,896,497	4,294,336	4,424,535	4,779,640
Operating income before income taxes	3,855,316	4,053,896	4,388,247	4,742,836
Income tax expense	1,461,488	1,544,720	1,669,917	1,804,681
Net income	\$ 2,393,828	\$ 2,509,176	\$ 2,718,330	\$ 2,938,155
Earnings per share:				
Basic	\$ 0.24	\$ 0.25	\$ 0.28	\$ 0.30
Diluted	\$ 0.23	\$ 0.24	\$ 0.26	\$ 0.28

---

**Table of Contents****Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures designed to ensure information required to be disclosed in its reports filed pursuant to the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure. The Company's management, including its Chief Executive Officer and Chief Financial Officer, does not expect that the Company's disclosure controls and procedures or internal controls will prevent all possible error and fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance the objectives of the control system are met. Further, the design of a control system must reflect the fact there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected.

The Company's management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the Company's disclosure controls and procedures (as defined in the exchange Act 13a-15(e)) as of March 31, 2007. Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer have concluded the Company's disclosure controls and procedures were not effective as of March 31, 2007, because of the material weaknesses discussed below.

**Management's Report on Internal Control over Financial Reporting**

The Company's management is responsible for establishing and maintaining adequate internal controls over financial reporting as defined in Rule 13a-15(f) of the Exchange Act. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation and fair presentation of financial statements in accordance with generally accepted accounting principles. The Company's management, including our chief executive officer and chief financial officer, conducted an evaluation of the design and operational effectiveness of our internal control over financial reporting as of March 31, 2007, the end of the fiscal year covered by this report using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework*. Based on this evaluation, management concluded, that as of March 31, 2007, we did not maintain effective internal controls over financial reporting in accordance with the COSO criteria, because management determined that we had material weaknesses in the design and operating effectiveness of our internal controls over financial reporting at March 31, 2007. A material weakness in internal control over financial reporting is a control deficiency (within the meaning of the Public Company Accounting Oversight Board's (PCAOB) Auditing Standard No. 2, or combination of control deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. PCAOB Auditing Standard No. 2 identifies a number of circumstances that, because of their likely significant negative effect on internal control over financial reporting, are to be regarded as at least significant deficiencies as well as strong indicators that a material weakness exists.

## **Table of Contents**

Such indicators include restatements of previously issued financial statements and adjustments made by independent accountants that were not initially identified by the company's internal control over financial reporting. During the year ended March 31, 2007 certain adjustments were identified by the auditors and were made to the financial statements.

Management has evaluated the nature and amount of the adjustments, and while it deems that such adjustments were not of a material magnitude, has nevertheless concluded that there are material weaknesses in internal control as defined under PCAOB Auditing Standard No. 2 as follows:

*Segregation of Duties and Limited Staff:* Based on the size of the Company, we have limited accounting personnel with the proper training to implement and maintain proper internal controls over financial reporting. During the fourth quarter ending March 31, 2007 the Company had a key departure in its accounting department, which exacerbated this issue. As a result of a limited staff, we are unable to have sufficient review by individuals not associated with the preparation of account analysis, reconciliation of accounts and preparation of the financial statements.

*Loan Loss Analysis:* The Company has identified loan loss analysis as a critical area where significant risk is associated with the proper analytical analysis and the use of sound estimates. The estimates and analytical work is subsequently used to arrive at proper reserve levels and adjustments that influence the Company's profitability in each reporting period. Historically, one individual does the majority of the work performed and the Company does not have the procedures and controls in place to have additional qualified individuals review these calculations and estimates.

*Accounting for Income Taxes:* The Company identified certain accounts related to the computation of the Company's income tax provision, income taxes payable and the deferred tax asset that were not fully reconciled on a timely basis.

The control deficiencies described above, either individually or in combination, could result in a misstatement of the aforementioned accounts or disclosures that would result in a material misstatement to the annual or interim consolidated financial statements that would not be prevented or detected. Management has determined that the above mentioned control deficiencies constitute material weaknesses. As a result of this conclusion and as part of the preparation of this report, we have applied compensating procedures and processes as necessary to ensure the reliability of our financial reporting. Accordingly, management believes, that (1) this report does not contain any untrue statement of a material fact, (2) omit a material fact necessary to make the statements made not misleading with respect to the period covered by this report, (3) and the financial statements, and other financial information included in this report, fairly present in all material respects our financial condition, results of operations and cash flows as of March 31, 2007 and for the period then ended.

### **Remedial Steps to Address the Material Weaknesses**

*Segregation of Duties and Limited Staff:* The Company will evaluate its current accounting staff and make decisions in regards to hiring additional qualified accounting personnel. The Company will also evaluate the possibility of outsourcing certain accounting functions to alleviate staffing issues and or segregation of duties issues.

*Loan Loss Analysis:* The management of the Company will work more directly with the Audit Committee in the loan loss analysis area. This might include additional information presented to the Audit Committee, additional in-house training and other steps to allow the Audit Committee to properly oversee and evaluate loan loss reserve assumptions and subsequent adjustments that affect profitability during respective reporting periods.

## **Table of Contents**

*Accounting for Income Taxes:* The Company will evaluate whether to hire an individual with expertise in the area of income taxes or if the deficiency in this area can be resolved with its current staff. The Company will also put into place the necessary changes to ensure that all reconciliations related to income taxes are performed on a timely basis.

These remediation plans will be implemented during the second and third quarters of fiscal 2008. The material weakness will not be considered remediated until the applicable remedial procedures operate for a period of time, such procedures are tested and management has concluded that the procedures are operating effectively.

The Company's independent registered public accounting firm, Dixon Hughes PLLC has issued an attestation report on management's assessment of the Company's internal control over financial reporting. The report appears below.

### **Change in Internal Control Over Financial Reporting**

No changes in the Company's internal control over financial reporting has 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.

### **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders

Nicholas Financial, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Nicholas Financial, Inc. and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of March 31, 2007 because of the effect of the material weaknesses identified in management's assessment, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

## **Table of Contents**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. The following material weaknesses have been identified and included in management's assessment.

*Segregation of Duties and Limited Staff:* Based on the size of the Company, it has limited accounting personnel with the proper training to implement and maintain proper internal controls over financial reporting. During the fourth quarter ending March 31, 2007 the Company had a key departure in its accounting department which exacerbated this issue. As a result of a limited staff, the Company is unable to have sufficient review by individuals not associated with the preparation of account analysis, reconciliation of accounts and preparation of the consolidated financial statements.

*Loan Loss Analysis:* The Company has identified loan loss analysis as a critical area where significant risk is associated with the proper analytical analysis and the use of sound estimates. The estimates and analytical work is subsequently used to arrive at proper reserve levels and adjustments that influence the Company's profitability in each reporting period. Historically, one individual does the majority of the work performed and the Company does not have the procedures and controls in place to have additional qualified individuals review these calculations and estimates.

*Accounting for Income Taxes:* The Company identified certain accounts related to the computation of the Company's income tax provision, income taxes payable and the deferred tax asset that were not fully reconciled on a timely basis.

In our opinion, management's assessment that the Company did not maintain effective internal control over financial reporting as of March 31, 2007, is fairly stated, in all material respects, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company did not maintain, in all material respects, effective internal control over financial reporting as of March 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

**Table of Contents**

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of March 31, 2007 and 2006 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the years in the three-year period ended March 31, 2007, and our report dated June 14, 2007, expressed an unqualified opinion on those consolidated financial statements. The material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2007 consolidated financial statements, and this report does not affect our report dated June 14, 2007, which expressed an unqualified opinion on those consolidated financial statements.

/s/ Dixon Hughes PLLC

Atlanta, Georgia

June 14, 2007

**Item 9B. Other Information**

None.

**Table of Contents**

**PART III**

**Item 10. Directors, Executive Officers and Corporate Governance**

The information set forth under the captions Proposal 1: Election of Directors, Board of Directors, Executive Officers and Compensation and Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement and Information Circular, dated on or about July 2, 2007, for the 2007 Annual General Meeting of Members of the Company to be held August 7, 2007 (the Proxy Statement), is incorporated herein by reference.

The Company has adopted a written code of ethics applicable to its principal executive officer, principal financial officer, principal accounting officer and persons performing similar functions. The text of this code of ethics is filed as Exhibit 14 to this Report. A copy of the code of ethics is also posted on the Company's web site at [www.nicholasfinancial.com](http://www.nicholasfinancial.com). The Company intends to satisfy the disclosure requirements under Item 5.05 of Form 8-K regarding amendments to, or waivers from, the code of ethics by posting such information on the Company's web site.

**Item 11. Executive Compensation, Compensation Interlocks and Insider Participation**

The information set forth under the Executive Officers and Compensation and Board of Directors Directors Compensation in the Proxy Statement is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

The information set forth under the captions Voting Shares and Ownership of Management and Principal Holders and Executive Officers and Compensation Equity Compensation Plan Information in the Proxy Statement is incorporated herein by reference.

**Item 13. Certain Relationships and Related Transactions, Director Independence and Board of Directors**

The information set forth under the caption Certain Relationships and Related Transactions in the Proxy Statement is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information set forth under the caption Proposal 3: Appointment of Independent Auditors in the Proxy Statement is incorporated herein by reference.

**Table of Contents****PART IV****Item 15. Exhibits and Financial Statement Schedules**

## (a)(1) Financial Statements

See Part II, Item 8, for the index of financial statements. All financial schedules are omitted as the required information is not applicable or the information is presented in the consolidated financial statements or related notes.

## (3) Exhibits

<b>Exhibit No.</b>	<b>Description</b>
3.1	Articles of Nicholas Financial, Inc. (1)
3.2	Notice of Articles of Nicholas Financial, Inc. (2)
4	Form of Common Stock Certificate (3)
10.1	Amended and Restated Loan and Security Agreement, dated August 1, 2000 (4)
10.2	Amendment No. 1 to Loan Agreement, dated March 16, 2001 (5)
10.3	Amendment No. 2 to Loan Agreement, dated July 31, 2001 (6)
10.4.1	Amendment No. 3 to Loan Agreement, dated June 27, 2002 (7)
10.4.2	Amendment No. 4 to Loan Agreement, dated June 30, 2004 (8)
10.4.3	Amendment No. 5 to Loan Agreement, dated March 31, 2005 (9)
10.4.4	Amendment No. 6 to Loan Agreement, dated September 15, 2005 (10)
10.4.5	Amendment No. 7 to Loan Agreement, dated February 1, 2006 (11)
10.4.6	Amendment No. 8 to Loan Agreement, dated March 27, 2007
10.5	Employee Stock Option Plan (12)
10.6	Non-Employee Director Stock Option Plan (13)
10.7	Employment Contract, dated November 22, 1999, between Nicholas Financial, Inc. and Ralph Finkenbrink, Senior Vice President of Finance (14)
10.8	Employment Contract, dated March 16, 2001, between Nicholas Financial, Inc. and Peter L. Vosotas, President and Chief Executive Officer (15)
10.9	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements (16)
10.10	ISDA Master Agreement, dated as of March 30, 1999, between Bank of America National Trust and Savings Association and Nicholas Financial, Inc. (including Schedule thereto) (17)
10.11	Form of Letter Agreement (confirming terms and conditions of Swap Transaction under the Master Agreement referred to in Exhibit 10.10 above) and Schedule thereto listing variable terms of outstanding Swap Transactions (18)
10.12	Nicholas Financial, Inc. Equity Incentive Plan (19)
10.13	Form of Nicholas Financial, Inc. Equity Incentive Plan Stock Option Award (20)
10.14	Form of Nicholas Financial, Inc. Equity Incentive Plan Restricted Stock Award (21)

**Table of Contents**

10.15 Form of Nicholas Financial, Inc. Equity Incentive Plan Performance Share Award (22)

14 Code of Ethics for Chief Executive Officer and Senior Financial Officers (23)

21 Subsidiaries of Nicholas Financial, Inc. (24)

23.1 Consent of Dixon Hughes PLLC

24 Powers of Attorney (included on signature page hereto)

31.1 Certification of President and Chief Executive Officer

31.2 Certification of Senior Vice President and Chief Financial Officer

32.1 Certification of the Chief Executive Officer Pursuant to 18 U.S.C. § 1350

32.2 Certification of the Chief Financial Officer Pursuant to 18 U.S.C. § 1350

- 
- (1) Incorporated by reference to Appendix B to the Company's Proxy Statement and Information Circular for the 2006 Annual General Meeting of Shareholders filed with the SEC on June 30, 2004 (File No. 0-26680).
  - (2) Incorporated by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-8 filed with the SEC on May 24, 2007 (SEC File No. 0-26680).
  - (3) Incorporated by reference to Exhibit 4 to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2004, as filed with the SEC on June 29, 2004.
  - (4) Incorporated by reference to Exhibit 10.1 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.
  - (5) Incorporated by reference to Exhibit 10.2 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.
  - (6) Incorporated by reference to Exhibit 10.3 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.
  - (7) Incorporated by reference to Exhibit 10.4 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.
  - (8) Incorporated by reference to Exhibit 10.1 to the Company's Form 10-QSB for the fiscal quarter ended June 30, 2004, as filed with the SEC on August 16, 2004.
  - (9) Incorporated by reference to Exhibit 10.4.3 to the Company's Form 10-KSB for the fiscal year ended March 31, 2005, as filed with the SEC on June 29, 2005.
  - (10) Incorporated by reference to Exhibit 10.4.4 to the Company's Form 10-Q for the quarter ended September 30, 2005, as filed with the SEC on November 11, 2005.
  - (11) Incorporated by reference to Exhibit 10.4.5 to the Company's Form 10-K for the fiscal year ended March 31, 2006, as filed with the SEC on June 29, 2006.
  - (12) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 filed with the SEC on June 30, 1999 (SEC File No. 333-81967).
  - (13) Incorporated by reference to Exhibit 4 to the Company's Registration Statement on Form S-8 filed with the SEC on June 30, 1999 (SEC File No. 333-81961).
  - (14) Incorporated by reference to Exhibit 10.7 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.
  - (15) Incorporated by reference to Exhibit 10.8 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on March 2, 2004.

**Table of Contents**

- (16) Incorporated by reference to Exhibit 21 to the Company's Annual Report on Form 10-KS for the fiscal year ended March 31, 2006, as filed with the SEC on June 29, 2006.
- (17) Incorporated by reference to Exhibit 10.10 to Amendment No. 2 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on April 7, 2004.
- (18) Incorporated by reference to Exhibit 10.11 to Amendment No. 2 to the Company's Registration Statement on Form S-2 (Reg. No. 333-113215) filed with the SEC on April 7, 2004.
- (19) Incorporated by reference to Appendix A to the Company's Proxy Statement and Information Circular for the 2006 Annual General Meeting of Shareholders filed with the SEC on June 30, 2006.
- (20) Incorporated by reference to Exhibit 4.4 to the Company's Registration Statement on Form S-8 filed with the SEC on May 24, 2007 (SEC File No. 0-26680).
- (21) Incorporated by reference to Exhibit 4.5 to the Company's Registration Statement on Form S-8 filed with the SEC on May 24, 2007 (SEC File No. 0-26680).
- (22) Incorporated by reference to Exhibit 4.6 to the Company's Registration Statement on Form S-8 filed with the SEC on May 24, 2007 (SEC File No. 0-26680).
- (23) Incorporated by reference to Exhibit 21 to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2004, as filed with the SEC on June 29, 2006.
- (24) Incorporated by reference to Exhibit 21 to the Company's Annual Report on Form 10-KSB for the fiscal year ended March 31, 2004, as filed with the SEC on June 29, 2004.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.**

Dated: June 14, 2007

By: /s/ Peter L. Vosotas  
 Peter L. Vosotas  
 Chairman, Chief Executive Officer and President

**KNOW ALL MEN BY THESE PRESENTS** that each person whose signature appears below constitutes and appoints Peter L. Vosotas and Ralph T. Finkenbrink, and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Report, and to file the same, with all exhibits thereto, and any other documents in connection therewith, with the U.S. Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorney-in-fact and agents or either of them, or their substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ Peter L. Vosotas Peter L. Vosotas	Chairman of the Board, Chief Executive Officer, President and Director	June 14, 2007
/s/ Ralph T. Finkenbrink Ralph T. Finkenbrink	Sr. Vice President Finance Chief Financial Officer, Chief Accounting Officer and Director	June 14, 2007
/s/ Stephen Bragin Stephen Bragin	Director	June 14, 2007
/s/ Alton R. Neal Alton R. Neal	Director	June 14, 2007
/s/ Scott Fink Scott Fink	Director	June 14, 2007

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
3.1	Articles of Nicholas Financial, Inc.*
3.2	Notice of Articles of Nicholas Financial, Inc.*
4	Form of Common Stock Certificate*
10.1	Amended and Restated Loan and Security Agreement, dated August 1, 2000*
10.2	Amendment No. 1 to Loan Agreement, dated March 16, 2001*
10.3	Amendment No. 2 to Loan Agreement, dated July 31, 2001*
10.4.1	Amendment No. 3 to Loan Agreement, dated June 27, 2002*
10.4.2	Amendment No. 4 to Loan Agreement, dated June 30, 2004*
10.4.3	Amendment No. 5 to Loan Agreement, dated March 31, 2005*
10.4.4	Amendment No. 6 to Loan Agreement, dated September 15, 2005*
10.4.5	Amendment No. 7 to Loan Agreement, dated February 1, 2006*
10.4.6	Amendment No. 8 to Loan Agreement, dated March 27, 2007
10.5	Employee Stock Option Plan*
10.6	Non-Employee Director Stock Option Plan*
10.7	Employment Contract, dated November 22, 1999, between Nicholas Financial, Inc. and Ralph Finkenbrink, Senior Vice President of Finance*
10.8	Employment Contract, dated March 16, 2001, between Nicholas Financial, Inc. and Peter L. Vosotas, President and Chief Executive Officer*
10.9	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements*
10.10	ISDA Master Agreement, dated as of March 30, 1999, between Bank of America National Trust and Savings Association and Nicholas Financial, Inc. (including Schedule thereto)*
10.11	Form of Letter Agreement (confirming terms and conditions of Swap Transaction under the Master Agreement referred to in Exhibit 10.10 above) and Schedule thereto listing variable terms of outstanding Swap Transactions*
10.12	Nicholas Financial, Inc. Equity Incentive Plan*
10.13	Form of Nicholas Financial, Inc. Equity Incentive Plan Stock Option Award*
10.14	Form of Nicholas Financial, Inc. Equity Incentive Plan Restricted Stock Award*
10.15	Form of Nicholas Financial, Inc. Equity Incentive Plan Performance Share Award*
14	Code of Ethics for Chief Executive Officer and Senior Financial Officers*
21	Subsidiaries of Nicholas Financial, Inc.*
23.1	Consent of Dixon Hughes PLLC

**Table of Contents**

24	Powers of Attorney (included on signature page hereto)
31.1	Certification of President and Chief Executive Officer
31.2	Certification of Senior Vice President and Chief Financial Officer
32.1	Certification of the Chief Executive Officer Pursuant to 18 U.S.C. §1350
32.2	Certification of the Chief Financial Officer Pursuant to 18 U.S.C. §1350

---

\* Incorporated by reference.