3M CO
Form 424B2
December 12, 2003

Prospectus Supplement to Prospectus dated October 20, 2003.

$1,500,000,000

3M Company

Medium-Term Notes, Series D

3M may offer from time to time medium-term notes, series D. The final terms of each note will be included in a pricing supplement. 3M will receive between $1,498,125,000 and $1,488,750,000 of the proceeds from the sale of the notes, before expenses and after paying the agents discounts and commissions of between $1,875,000 and $11,250,000. The following terms may apply to the notes.

- Mature nine months or longer
- Fixed or floating interest rate, zero-coupon or issued with original issue discount; a floating interest rate may be based on:
- Commercial paper rate
- Prime rate
- CD rate
- Federal funds rate
- LIBOR
- EURIBOR
- Treasury rate
- CMT rate
- 11th district cost of funds rate
- Any other rate specified by us in a pricing supplement
- Any combination of rates specified in a pricing supplement
- Amount of principal or interest may be determined by reference to an index or formula
- Book-entry form only
- May be subject to redemption by us or repurchase at the option of the Holder
- Not amortized or subject to a sinking fund
- Interest paid on fixed rate notes semi-annually
- Interest paid on floating rate notes monthly, quarterly, semi-annually or annually
- Minimum denominations of $1,000 and whole multiples of $1,000
- Fully registered form
- May be foreign currency or composite currency denominated
- Same day settlement and payment in immediately available funds

We do not plan to list the notes for trading on a securities exchange.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

We may sell the notes directly or through one or more agents or dealers, including the agents listed below. The agents are not required to sell any specific number or amount of the notes. They will use their reasonable best efforts to sell the notes offered. No commission will be payable on sales that we make directly. There is no established trading market for the notes and there can be no assurance that a secondary market for the notes will develop.

Goldman, Sachs & Co.

Citigroup

JPMorgan

Merrill Lynch & Co.

Morgan Stanley

UBS Investment Bank

Prospectus Supplement dated December 12, 2003.

ABOUT THIS PROSPECTUS SUPPLEMENT

You should read this prospectus supplement along with the accompanying prospectus and your pricing supplement. These documents contain information you should consider when making your investment decision. You should rely on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus and your pricing supplement. We have not, and the agents have not, authorized anyone else to provide you with different or additional information. If anyone provides you with different or inconsistent information, you should not rely on it.

This prospectus supplement, the accompanying prospectus and your pricing supplement do not constitute an offer to sell or a solicitation of an offer to buy any securities other than the notes. This prospectus supplement, the accompanying prospectus and the applicable pricing supplement do not constitute an offer to sell or a solicitation of an offer to buy such notes in any circumstances in which such offer or solicitation is unlawful.

Information in this prospectus supplement, the accompanying prospectus or your pricing supplement may change after the date on the front of the applicable document. You should not interpret the delivery of this prospectus supplement, the accompanying prospectus or your pricing supplement or the sale of the notes, as an indication that there has been no change in our affairs since those dates.

DESCRIPTION OF NOTES WE MAY OFFER

Please note that in this section entitled Description of Notes We May Offer , references to 3M , we , our and us mean 3M Company, unles the context indicates otherwise. Also, in this section, references to Holders mean those who own notes registered in their own names, on the books that we or the Trustee maintain for this purpose, and not those who own beneficial interests in notes registered in street name or in notes issued in book-entry form through The Depository Trust Company. Owners of beneficial interests in the notes should read the subsection entitled Legal Ownership of Notes . Certain defined terms used throughout this prospectus supplement are in quotation marks and bold print where they are first defined.

Information About Our Medium-Term Note Program

The Notes Will Be Issued Under the Indenture

As required by U.S. federal law for all bonds and notes of companies that are publicly offered, the notes are governed by a document called the indenture. The indenture dated November 17, 2000 is a contract between us and Citibank, N.A., which acts as trustee. The trustee has two main roles:

First, the trustee can enforce your rights against us if we default. There are limitations on the extent to which the trustee acts on your behalf, which we describe in the accompanying prospectus under Description of Debt Securities Events of Default ; and

Second, the trustee performs administrative duties for us, such as sending you interest payments and notices.

We May Issue Other Series of Debt Securities

The indenture permits us to issue different series of debt securities from time to time. The series D medium-term notes will be a single, distinct series of debt securities. We may, however, issue notes in such amounts, at such times and on such terms as we wish. The notes will differ from one another, and from other series, in their terms.

This section summarizes the material terms that will apply generally to the notes as a series and adds to, and to the extent inconsistent therewith replaces, the description of the general terms and provisions of the debt securities contained in the accompanying prospectus. Each particular note will have financial and other terms

specific to it, and the specific terms of each note will be described in a pricing supplement. Those terms may vary from the terms described here. As you read this section, therefore, please remember that the specific terms of your note as described in your pricing supplement will supplement and, if applicable, may modify or replace the general terms described in this section. The statements we make in this section may not apply to your note.

When we refer to the notes, the series D medium-term notes or these notes, we mean our medium-term notes, series D. When we refer to a series of debt securities, we mean a series, such as the notes, issued under the indenture. When we refer to your pricing supplement, we mean the pricing supplement describing the specific terms of the note you purchase.

Amounts That We May Issue

The indenture does not limit the aggregate amount of debt securities that we may issue, nor does it limit the number of series or the aggregate amount of any particular series. We have initially authorized the issuance of series D medium-term notes in such amounts as will not result in the notes having an aggregate initial offering price greater than $1,500,000,000, or an equivalent amount in any other currency or currency unit. We may, however, increase this authorized amount at any time without your consent. The indenture and the notes do not limit our ability to incur other indebtedness or to issue other securities. Also, we are not subject to financial or similar restrictions by the terms of the notes, except as described under Description of Debt Securities Restrictions on Secured Funded Debt and Restrictions on Sale and Lease-Back Transactions in the accompanying prospectus.

How the Notes Rank Against Other Debt

The series D medium-term notes will not be secured by any of our property or assets or any of our subsidiaries property or assets. Thus, by owning a note, you are one of our unsecured creditors.

The notes will not be subordinated to any of our other debt obligations. This means that, in a bankruptcy or liquidation proceeding against us, the notes would rank equally in right of payment with all of our other unsecured and unsubordinated debt.

This Section is Only a Summary

The indenture and its associated documents, including your note, contain the full legal text of the matters described in this section, the accompanying prospectus and your pricing supplement. The indenture and the notes are governed by New York law. A copy of the indenture has been filed with the SEC. See About this Prospectus and Where You Can Find Additional Information in the accompanying prospectus for information on how to obtain a copy.

This section, the accompanying prospectus and your pricing supplement summarize all the material terms of the indenture and your note. They do not, however, describe every aspect of the indenture and your note. For example, in this section, the accompanying prospectus and your pricing supplement, we use terms that have been given special meaning in the indenture, but we describe the meaning of only the more important of those terms.

Features Common to All Notes

Stated Maturity and Maturity

The day on which the principal amount of your note is scheduled to become due is called the stated maturity of the principal and is specified in your pricing supplement. The principal may become due sooner, by reason of redemption, repayment or acceleration after a default. The day on which the principal actually becomes due, whether at the stated maturity or earlier, is called the maturity of the principal.

We also use the terms stated maturity and maturity to refer to the dates when other payments become due. For example, we may refer to a regular interest payment date when an installment of interest is scheduled to become due as the stated maturity of that installment. When we refer to the stated maturity or the maturity of

a note without specifying a particular payment, we mean the stated maturity or maturity of the principal, as the case may be.

Currency of Notes

Amounts that become due and payable on your note will be payable in a currency, composite currency, basket of currencies or currency unit or units specified in your pricing supplement. We refer to this currency, composite currency, basket of currencies or currency unit or units as a specified currency . The specified currency for your note will be U.S. dollars, unless your pricing supplement states otherwise. Some notes may have different specified currencies for principal and interest.

You will have to pay for your notes by delivering the requisite amount of the specified currency for the principal to the agent that we name in your pricing supplement, unless other arrangements have been made between you and us or you and that agent. We will make payments on your notes in the specified currency, except as described below in Payment Mechanics .

Types of Notes

We will issue the following three types of notes:

Fixed Rate Notes. A note of this type will bear interest at a fixed rate described in the applicable pricing supplement. This type includes zero coupon notes, which bear no interest and are instead issued at a price lower than the principal amount.

Floating Rate Notes. A note of this type will bear interest at rates that are determined by reference to an interest rate formula. In some cases, the rates may also be adjusted by adding or subtracting a spread or multiplying by a spread multiplier and may be subject to a minimum rate or a maximum rate. The various interest rate formulas and these other features are described below in Interest Rates Floating Rate Notes . If your note is a floating rate note, the formula and any adjustments that apply to the interest rate will be specified in your pricing supplement.

Indexed Notes. A note of this type provides that the principal amount payable at its maturity, and/or the amount of interest payable on an interest payment date, will be determined by reference to a current exchange rate, a composite currency, commodity price or other financial or non-financial indices described in the applicable pricing supplement. If you are a Holder of an indexed note, you may receive a principal amount at maturity that is greater than or less than the face amount of your note depending upon the value of the applicable index at maturity. That value may fluctuate over time. If you purchase an indexed note, your pricing supplement will include information about the relevant index, how amounts that are to become payable will be determined by reference to that index, risks of indexed note investment that are not associated with an investment in other types of notes, any applicable foreign currency risks and certain risks and additional tax considerations associated with that indexed note. For a description of certain risks associated with indexed notes, see Risks Associated with Indexed Notes and Foreign Currency Risks below.

Original Issue Discount Notes

A fixed rate note, a floating rate note or an indexed note may be an original issue discount note. A note of this type is issued at a price lower than its principal amount and provides that, upon redemption, repayment or acceleration of its maturity, an amount less than its principal amount will be payable. A note issued at a discount to its principal may, for U.S. federal income tax purposes, be considered an original issue discount note, regardless of the amount payable upon redemption, repayment or acceleration of maturity. See United States Taxation United States Holders Original Issue Discount below for a brief description of the U.S. federal income tax consequences of owning an original issue discount note.

Information in the Pricing Supplement

Your pricing supplement will describe one or more of the following terms of your note:

the stated maturity;

- the specified currency or currencies for principal and interest, if not U.S. dollars;
- the price at which we originally issue your note, expressed as a percentage of the principal amount, and the original issue date;
- whether your note is a fixed rate note, a floating rate note or an indexed note and also whether it is an original issue discount note;
- if your note is a fixed rate note, the yearly rate at which your note will bear interest, if any, and the interest payment dates, if different from those set forth below under Interest Rates Fixed Rate Notes ;
- if your note is a floating rate note, the interest rate basis, which may be one of the nine base rates described in Interest Rates Floating Rate Notes below; any applicable index currency or maturity, spread or spread multiplier or initial, maximum or minimum rate; the interest reset, determination, calculation and payment dates; and the calculation agent, all of which we describe under Interest Rates Floating Rate Notes below;
- if your note is an original issue discount note, the yield to maturity and any additional provisions relating to this feature of the note;
- if your note is an indexed note, the principal amount, if any, we will pay you at maturity, the amount of interest, if any, we will pay you on an interest payment date or the formula we will use to calculate these amounts, if any;
- whether your note may be redeemed at our option or repaid at the Holder s option prior to the stated maturity and, if so, other relevant terms such as the redemption commencement date, repayment date(s), redemption price(s) and redemption period(s), all of which we describe under Redemption and Repayment below;
- whether we will issue or make available your note in non-book-entry form; and
- any other terms of your note that are not inconsistent with the provisions of the indenture, which other terms could be different from those described in this prospectus supplement.

Your pricing supplement will summarize specific financial and other terms of your note, while this prospectus supplement describes terms that apply generally to the notes as a series and the accompanying prospectus describes the general terms and provisions of the debt securities issued under the indenture. Consequently, the terms described in your pricing supplement will supplement those described in this prospectus supplement and the terms described in this prospectus supplement will supplement those described in the accompanying prospectus. In the event that the terms described in these documents are inconsistent, the terms described in the document that is dated later will be controlling. The terms used in your pricing supplement have the meanings described in this prospectus supplement and the accompanying prospectus, unless otherwise specified.

Legal Ownership of Notes

We refer to those who have notes registered in their own names, on the books that we or the trustee maintain for this purpose, as the Holders of those notes. These persons are the legal holders of the notes. We refer to those who, indirectly through others, own beneficial interests in notes that are not registered in their own

names as indirect holders of those notes. As we discuss below, indirect holders are not legal holders, and investors in notes issued in book-entry form or in street name will be indirect holders.

Book-Entry Holders

We will issue each note in book-entry form only, unless we specify otherwise in the applicable pricing supplement. This means notes will be represented by one or more global notes registered in the name of a financial institution that holds them as depositary on behalf of other

financial institutions that participate in the depositary s book-entry system. These participating institutions, in turn, hold beneficial interests in the notes on behalf of themselves or their customers.

Under the indenture, only the person in whose name a note is registered is recognized as the Holder of that note. Consequently, for notes issued in global form, we will recognize only the depositary as the Holder of the notes and we will make all payments on the notes to the depositary. The depositary passes along the payments it receives to its participants, which in turn pass the payments along to their customers who are the beneficial owners. The depositary and its participants do so under agreements they have made with one another or with their customers; they are not obligated to do so under the terms of the notes.

As a result, investors will not own notes directly. Instead, they will own beneficial interests in a global note, through a bank, broker or other financial institution that participates in the depositary s book-entry system or holds an interest through a participant. As long as the notes are issued in global form, investors will be indirect holders, and not Holders, of the notes.

Street Name Holders

In the future we may terminate a global note or issue notes initially in non-global form. In these cases, investors may choose to hold their notes in their own names or in street name . Notes held by an investor in street name would be registered in the name of a bank, broker or other financial institution that the investor chooses, and the investor would hold only a beneficial interest in those notes through an account he or she maintains at that institution.

For notes held in street name, we will recognize only the intermediary banks, brokers and other financial institutions in whose names the notes are registered as the Holders of those notes and we will make all payments on those notes to them. These institutions pass along the payments they receive to their customers who are the beneficial owners, but only because they agree to do so in their customer agreements or because they are legally required to do so. Investors who hold notes in street name will be indirect holders, not Holders, of those notes.

Legal Holders

Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, run only to the Holders of the notes. We do not have obligations to investors who hold beneficial interests in global notes, in street name or by any other indirect means. This will be the case whether an investor chooses to be an indirect holder of a note or has no choice because we are issuing the notes only in global form.

For example, once we make a payment or give a notice to the Holder, we have no further responsibility for that payment or notice even if that Holder is required, under agreements with depositary participants or customers or by law, to pass it along to the indirect holders but does not do so. Similarly, if we want to obtain the approval of the Holders for any purpose e.g., to amend the indenture or to relieve us of the consequences of a default or of our obligation to comply with a particular provision of the indenture we would seek the approval only from the Holders, and not the indirect holders, of the notes. Whether and how the Holders contact the indirect holders is up to the Holders.

When we refer to you , we mean those who invest in the notes being offered by this prospectus supplement and accompanying prospectus, whether they are the Holders or only indirect holders of those notes. When we refer to your notes , we mean the notes in which you hold a direct or indirect interest.

Special Considerations for Indirect Holders

If you hold notes through a bank, broker or other financial institution, either in book-entry form or in street name, you should check with your own institution to find out:

how it handles securities payments and notices;

whether it imposes fees or charges;

how it would handle a request for the Holders consent, if ever required;

whether and how you can instruct it to send you notes registered in your own name so you can be a Holder, if that is permitted in the future;

how it would exercise rights under the notes if there were a default or other event triggering the need for Holders to act to protect their interests; and

if the notes are in book-entry form, how the depositary s rules and procedures will affect these matters.

What Is a Global Note?

We will issue each note in book-entry form only, unless we specify otherwise in the applicable pricing supplement. Each note issued in book-entry form will be represented by a global note that we deposit with and register in the name of a financial institution or its nominee, that we select. The financial institution that we select for this purpose is called the depositary . Unless we specify otherwise in the applicable pricing supplement, The Depository Trust Company, New York, New York, or DTC , will be the depositary for all notes issued in book-entry form. See Information About The Depository Trust Company below.

A global note may represent one or any other number of individual notes. All notes represented by the same global note will have the same terms.

A global note may not be transferred to or registered in the name of anyone other than the depositary or its nominee, unless special termination situations arise. We describe those situations below under Special Situations When a Global Note Will Be Terminated . As a result of these arrangements, the depositary, or its nominee, will be the sole registered owner and Holder of all notes represented by a global note, and investors will be permitted to own only beneficial interests in a global note. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depositary or with another institution that does. Thus, an investor whose note is represented by a global note will not be a Holder of the note, but only an indirect holder of a beneficial interest in the global note.

If the pricing supplement for a particular note indicates that the note will be issued in global form only, then the note will be represented by a global note at all times unless and until the global note is terminated. We describe the situations in which this can occur below under Special Situations When a Global Note Will Be Terminated . If termination occurs, we may issue the notes through another book-entry clearing system or decide that the notes may no longer be held through any book-entry clearing system.

Special Considerations for Global Notes

As an indirect holder, an investor s rights relating to a global note will be governed by the account rules of the investor s financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a Holder of notes and instead deal only with the depositary that holds the global note.

If notes are issued only in the form of a global note, an investor should be aware of the following:

An investor cannot cause the notes to be registered in his or her own name, and cannot obtain non-global certificates for his or her interest in the notes, except in the special situations we describe below;

An investor will be an indirect holder and must look to his or her own bank or broker for payments on the notes and protection of his or her legal rights relating to the notes, as we describe under Legal Ownership of Notes above;

An investor may not be able to sell interests in the notes to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form;

An investor may not be able to pledge his or her interest in a global note in circumstances where certificates representing the notes must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective;

The depositary s policies, which may change from time to time, will govern payments, transfers, exchanges, notices and other matters relating to an investor s interest in a global note. We and the trustee have no responsibility for any aspect of the depositary s policies or actions or for its records of ownership interests in a global note. We and the trustee also do not supervise the depositary in any way;

The depositary will require that those who purchase and sell interests in a global note within its book-entry system use immediately available funds and your broker or bank may require you to do so as well; and

Financial institutions that participate in the depositary s book-entry system, and through which an investor holds its interest in the global notes, may also have their own policies affecting payments, transfers, exchanges, notices and other matters relating to the notes. There may be more than one financial intermediary in the chain of ownership for an investor. We do not monitor and are not responsible for the actions of any of those intermediaries.

Special Situations When a Global Note Will Be Terminated

In a few special situations described below, a global note will be terminated and interests in it will be exchanged for certificates in a non-global form representing the notes it represented. After that exchange, the choice of whether to hold the notes directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global note transferred on termination to their own names, so that they will be Holders. We have described the rights of Holders and street name investors above under Legal Ownership of Notes .

The special situations for termination of a global note are as follows:

if the depositary notifies us that it is unwilling or unable to continue as depositary for that global note or if the depository ceases to be a clearing agency registered under the Securities Exchange Act of 1934 and a successor depositary is not appointed by us within 90 days of receiving such notice or becoming aware of such ineligibility;

if we notify the trustee that we wish to terminate that global note; or

if an event of default has occurred with regard to notes represented by that global note and has not been cured or waived; we discuss defaults in the accompanying prospectus under Description of Debt Securities Events of Default .

If a global note is terminated, only the depositary, and not we or the trustee, is responsible for deciding the names of the institutions in whose names the notes represented by the global note will be registered and, therefore, who will be the Holders of those notes.

Information About The Depository Trust Company

DTC has provided the following information to us. DTC is:

a limited-purpose trust company organized under the laws of the State of New York;

a banking organization within the meaning of the New York Banking Law;

a member of the Federal Reserve System;

a clearing corporation within the meaning of the New York Uniform Commercial Code; and

a clearing agency registered under the Securities Exchange Act of 1934.

Interest Rates

This subsection describes the different kinds of interest rates that may apply to your note, if it bears interest.

Fixed Rate Notes

Each fixed rate note, except any zero coupon note, will bear interest from its original issue date or from the most recent date to which interest on the note has been paid or made available for payment. Interest will accrue on the principal of a fixed rate note at the fixed yearly rate stated in the applicable pricing supplement, until the principal is paid or made available for payment. Unless otherwise specified in the applicable pricing supplement, interest on a fixed rate note will be payable semiannually each May 15 and November 15, which will be the interest payment dates for a fixed rate note, and at maturity. Each payment of interest due on an interest payment date or the date of maturity will include interest accrued from and including the last date to which interest has been paid, or made available for payment, or from the issue date if none has been paid, or made available for payment, to but excluding the interest payment date or the date of maturity. If, however, an interest payment date or the maturity date of a fixed rate note falls on a day that is not a business day, we will make the required payment of principal, premium, if any, and/or interest on the next succeeding business day, and no additional interest will accrue with respect to the payment made on that next succeeding business day. We will compute interest on fixed rate notes on the basis of a 360-day year of twelve 30-day months. We will pay interest on each interest payment date and at maturity as described below under Payment Mechanics . If the original issue date of a note is between a regular record date and the corresponding interest payment date, the initial interest payment will be made to the holder of record on the next interest payment date after the next regular record date.

Floating Rate Notes

*In this subsection, we use several specialized terms relating to the manner in which floating interest rates are calculated. These terms appear in **bold, italicized** type the first time they appear, and we define these terms in Special Rate Calculation Terms at the end of this subsection.*

Also, please remember that the specific terms of your note as described in your pricing supplement will supplement and, if applicable, may modify or replace the general terms regarding the floating rates of interest described in this subsection. The statements we make in this subsection may not apply to your note.

Each floating rate note will bear interest from its original issue date or from the most recent date to which interest on the note has been paid or made available for payment. Interest will accrue on the principal of a floating

rate note at the yearly rate determined pursuant to the interest rate formula stated in the applicable pricing supplement, until the principal is paid or made available for payment. We will pay interest on each interest payment date and at maturity as described below under Payment Mechanics .

Base Rates. We currently expect to issue floating rate notes that bear interest at rates based on one or more of the following base rates:

- commercial paper rate;
- prime rate;
- CD rate;
- federal funds rate;
- LIBOR;
- EURIBOR;
- treasury rate;

CMT rate; and/or

11th district rate.

We describe each of these base rates in further detail below in this subsection. If you purchase a floating rate note, your pricing supplement will specify the type of base rate that applies to your note.

Initial Base Rate. For any floating rate note, the base rate in effect from the original issue date to the first interest reset date will be the initial base rate. We will specify the initial base rate in the applicable pricing supplement.

Spread or Spread Multiplier. In some cases, the base rate for a floating rate note may be adjusted:

by adding or subtracting a specified number of basis points, called the spread, with one basis point being 0.01%; or

by multiplying the base rate by a specified percentage, called the spread multiplier.

If you purchase a floating rate note, your pricing supplement will specify whether a spread or spread multiplier will apply to your note and, if so, the amount of the spread or spread multiplier.

Maximum and Minimum Rates. The actual interest rate, after being adjusted by the spread or spread multiplier, may also be subject to either or both of the following limits:

a maximum rate, which is a specified upper limit that the actual interest rate in effect at any time may not exceed; and/or

a minimum rate, which is a specified lower limit that the actual interest rate in effect at any time may not fall below.

If you purchase a floating rate note, your pricing supplement will specify whether a maximum rate and/or minimum rate will apply to your note and, if so, what those rates are.

Whether or not a maximum rate applies, the interest rate on a floating rate note will in no event be higher than the maximum rate permitted by New York law, as it may be modified by U.S. law of general application. Under current New York law, the maximum rate of interest, with some exceptions, for any loan in an amount less than $250,000 is 16% and for any loan in the amount of $250,000 or more but less than $2,500,000 is 25% per year on a simple interest basis. These limits do not apply to loans of $2,500,000 or more. The indenture is, and any notes issued under the indenture will be, governed by New York law.

The rest of this subsection describes how the interest rate and the interest payment dates will be determined, and how interest will be calculated, on a floating rate note.

Interest Reset Dates. The rate of interest on a floating rate note will be reset, by the calculation agent described below, daily, weekly, monthly, quarterly, semi-annually or annually. The date on which the interest rate resets and the reset rate becomes effective is called the interest reset date. Except as otherwise specified in the applicable pricing supplement, the interest reset date will be as follows:

for floating rate notes that reset daily, each ***business day***;

for floating rate notes that reset weekly and are not treasury rate notes, the Wednesday of each week;

for treasury rate notes that reset weekly, the Tuesday of each week;

for floating rate notes that reset monthly, the third Wednesday of each month;

for floating rate notes that reset quarterly, the third Wednesday of March, June, September and December of each year;

for floating rate notes that reset semi-annually, the third Wednesday of each of two months of each year as specified in the applicable pricing supplement; and

for floating rate notes that reset annually, the third Wednesday of one month of each year as specified in the applicable pricing supplement.

For a floating rate note, the interest rate in effect on any particular day will be the interest rate determined with respect to the latest interest reset date that occurs on or before that day. There are several exceptions, however, to the reset provisions described above.

The base rate in effect from the original issue date to the first interest reset date will be the initial base rate. For floating rate notes that reset daily or weekly, the base rate in effect for each day following the second business day before an interest payment date to, but excluding, the interest payment date, and for each day following the second business day before the maturity to, but excluding, the maturity, will be the base rate in effect on that second business day.

If any interest reset date for a floating rate note would otherwise be a day that is not a business day, the interest reset date will be postponed to the next day that is a business day. For a LIBOR or EURIBOR note, however, if that business day is in the next succeeding calendar month, the interest reset date will be the immediately preceding business day.

Interest Determination Dates. The interest rate that takes effect on an interest reset date will be determined by the calculation agent by reference to a particular date called an interest determination date. Except as otherwise specified in the applicable pricing supplement:

For all floating rate notes other than LIBOR notes, EURIBOR notes, treasury rate notes and 11th district rate notes, the interest determination date relating to a particular interest reset date will be the second business day before the interest reset date.

For LIBOR notes, the interest determination date relating to a particular interest reset date will be the second ***London business day*** preceding the interest reset date, unless the ***index currency*** is pounds sterling, in which case the interest determination date will be the interest reset date. We refer to an interest determination date for a LIBOR note as a LIBOR interest determination date.

For EURIBOR notes, the interest determination date relating to a particular interest reset date will be the second ***Euro business day*** preceding the interest reset date. We refer to an interest determination date for a EURIBOR note as a EURIBOR interest determination date.

For treasury rate notes, the interest determination date relating to a particular interest reset date, which we refer to as a treasury interest determination date, will be the day of the week in which the interest reset date falls on which treasury bills i.e., direct obligations of the U.S. government would normally be auctioned. Treasury bills are usually sold at auction on the Monday of each week, unless that day is a legal holiday, in which case the auction is usually held on the following Tuesday, except that the auction may be held on the preceding Friday. If as the result of a legal holiday an auction is held on the preceding Friday, that Friday will be the treasury interest determination date relating to the interest reset date occurring in the next succeeding week.

For 11th district rate notes, the interest determination date relating to a particular interest reset date will be the last working day, in the first calendar month before that interest reset date, on which the Federal Home Loan Bank of San Francisco publishes the monthly average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District for the second calendar month before that interest reset date. We refer to an interest determination date for an 11th district rate note as an 11th district interest determination date.

Interest Calculation Dates. As described above, the interest rate that takes effect on a particular interest reset date will be determined by reference to the corresponding interest determination date. Except for LIBOR notes and EURIBOR notes, however, the determination of the rate

will actually be made on a day no later than the corresponding interest calculation date. The interest calculation date will be the earlier of the following:

the tenth calendar day after the interest determination date or, if that tenth calendar day is not a business day, the next succeeding business day; and

the business day immediately preceding the interest payment date or the maturity, whichever is the day on which the next payment of interest will be due.

The calculation agent need not wait until the relevant interest calculation date to determine the interest rate if the rate information it needs to make the determination is available from the relevant sources sooner.

Interest Payment Dates. The interest payment dates for a floating rate note will depend on when the interest rate is reset and, unless we specify otherwise in the applicable pricing supplement, will be as follows:

for floating rate notes that reset daily, weekly or monthly, the third Wednesday of each month or the third Wednesday of March, June, September and December of each year, as specified in the applicable pricing supplement;

for floating rate notes that reset quarterly, the third Wednesday of March, June, September and December of each year;

for floating rate notes that reset semi-annually, the third Wednesday of the two months of each year specified in the applicable pricing supplement;

for floating rate notes that reset annually, the third Wednesday of the month specified in the applicable pricing supplement; and

at maturity.

Regardless of these rules, if a note is originally issued after the regular record date and before the date that would otherwise be the first interest payment date, the first interest payment date will be the date that would otherwise be the second interest payment date. We have defined the term regular record date below under Payment Mechanics Regular Record Dates for Interest .

In addition, the following special provision will apply to a floating rate note with regard to any interest payment date other than one that falls on the maturity. If the interest payment date would otherwise fall on a day that is not a business day, then the interest payment date will be the next day that is a business day. However, if the floating rate note is a LIBOR note or a EURIBOR note and the next business day falls in the next calendar month, then the interest payment date will be advanced to the next preceding day that is a business day. In all cases, an interest payment date that falls on the maturity will be made on the next succeeding business day, but interest on that payment will not accrue after the maturity.

Calculation of Interest. Calculations relating to floating rate notes will be made by the calculation agent. Unless the applicable pricing supplement states otherwise, the calculation agent for any issue of floating rate notes will be Citibank, N.A. We may appoint a different institution to serve as calculation agent from time to time after the original issue date of the note without your consent and without notifying you of the change.

For each floating rate note, the calculation agent will determine, on the corresponding interest calculation or determination date, as applicable, the interest rate that takes effect on each interest reset date. In addition, the calculation agent will calculate the amount of interest that has accrued during each interest period i.e., the period from and including the original issue date, or the last date to which interest has been paid or made available for payment, to but excluding the payment date. For each interest period, the calculation agent will calculate the amount of accrued interest by multiplying the face amount of the floating rate note by an accrued interest factor for the interest period. This factor will equal the sum of the interest factors calculated for each day during the interest period. The interest factor for each day will be expressed as a decimal and will be calculated by dividing the interest rate, also expressed as a decimal, applicable to that day:

by 360, in the case of commercial paper rate notes, prime rate notes, LIBOR notes, EURIBOR notes, CD rate notes, federal funds rate notes and 11th district rate notes; or

by the actual number of days in the year, in the case of treasury rate notes and CMT rate notes.

Upon the request of the Holder of any floating rate note, the calculation agent will provide for that note the interest rate then in effect and, if determined, the interest rate that will become effective on the next interest reset date. The calculation agent s determination of any interest rate, and its calculation of the amount of interest for any interest period, will be final and binding in the absence of manifest error.

All percentages resulting from any calculation relating to a note will be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point (e.g., 9.876541% (or .09876541) being rounded down to 9.87654% (or ..0987654) and 9.876545% (or .09876545) being rounded up to 9.87655% (or .0987655)). All amounts used in or resulting from any calculation relating to a floating rate note will be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, or to the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, with one-half cent or one-half of a corresponding hundredth of a unit or more being rounded upward.

In determining the base rate that applies to a floating rate note during a particular interest period, the calculation agent may obtain rate quotes from various banks or dealers active in the relevant market, as described in the following subsections. Those reference banks and dealers may include the calculation agent itself and its affiliates, as well as any agent and its affiliates.

Commercial Paper Rate Notes

If you purchase a commercial paper rate note, your note will bear interest at a base rate equal to the commercial paper rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The commercial paper rate will be the ***money market yield*** of the rate, for the relevant interest determination date, for commercial paper having the ***index maturity*** specified in your pricing supplement, as published in H.15(519) under the heading Commercial Paper Nonfinancial . If the commercial paper rate cannot be determined as described above, the following procedures will apply.

If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the commercial paper rate will be the rate, for the relevant interest determination date, for commercial paper having the index maturity specified in your pricing supplement, as published in ***H.15 daily update*** or any other recognized electronic source used for displaying that rate, under the heading Commercial paper Nonfinancial .

If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the commercial paper rate will be the money market yield of the arithmetic mean of the following offered rates for U.S. dollar commercial paper that has the relevant index maturity and is placed for an industrial issuer whose bond rating is AA , or the equivalent, from a nationally recognized rating agency: the rates offered as of 11:00 A.M., New York City time, on the relevant interest determination date, by three leading U.S. dollar commercial paper dealers in New York City selected by the calculation agent.

If fewer than three dealers selected by the calculation agent are quoting as described in the prior paragraph, the commercial paper rate for the new interest period will be the commercial paper rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

Prime Rate Notes

If you purchase a prime rate note, your note will bear interest at a base rate equal to the prime rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The prime rate will be the rate, for the relevant interest determination date, published in H.15(519) under the heading Bank prime loan . If the prime rate cannot be determined as described above, the following procedures will apply.

If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the prime rate will be the rate, for the relevant interest determination date, as published in H.15 daily update or another recognized electronic source used for the purpose of displaying that rate, under the heading Bank prime loan .

If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), then the prime rate will be the arithmetic mean of the following rates as they appear on the ***Reuters screen US PRIME 1 page***: the rate of interest publicly announced by each bank appearing on that page as that bank s prime rate or base lending rate, as of 11:00 A.M., New York City time, on the relevant interest determination date.

If fewer than four of these rates appear on the Reuters screen US PRIME 1 page, the prime rate will be the arithmetic mean of the prime rates or base lending rates, as of the close of business on

the relevant interest determination date, of three major banks in New York City selected by the calculation agent. For this purpose, the calculation agent will use rates quoted on the basis of the actual number of days in the year divided by a 360-day year.

If fewer than three banks selected by the calculation agent are quoting as described in the prior paragraph, the prime rate for the new interest period will be the prime rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

CD Rate Notes

If you purchase a CD rate note, your note will bear interest at a base rate equal to the CD rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The CD rate will be the rate, on the relevant interest determination date, for negotiable U.S. dollar certificates of deposit having the index maturity specified in your pricing supplement, as published in H.15(519) under the heading CDs (secondary market) . If the CD rate cannot be determined in this manner, the following procedures will apply.

If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the CD rate will be the rate, for the relevant interest determination date, described above as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading CDs (secondary market) .

If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the CD rate will be the arithmetic mean of the following secondary market offered rates for negotiable U.S. dollar certificates of deposit of major U.S. money center banks with a remaining maturity closest to the specified index maturity, and in a representative amount: the rates offered as of 10:00 A.M., New York City time, on the relevant interest determination date, by three leading nonbank dealers in negotiable U.S. dollar certificates of deposit in New York City, as selected by the calculation agent.

If fewer than three dealers selected by the calculation agent are quoting as described in the prior paragraph, the CD rate in effect for the new interest period will be the CD rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

Federal Funds Rate Notes

If you purchase a federal funds rate note, your note will bear interest at a base rate equal to the federal funds rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The federal funds rate will be the rate for U.S. dollar federal funds on the relevant interest determination date, as published in H.15 (519) under the heading Federal funds (effective) , as that rate is displayed on ***Moneyline Telerate page*** 120. If the federal funds rate cannot be determined in this manner, the following procedures will apply.

If the rate described above is not displayed on Moneyline Telerate page 120 at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the federal funds rate, for the relevant

interest determination date, will be the rate described above as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading Federal funds (effective) .

If the rate described in the prior paragraph is not displayed on Moneyline Telerate page 120 and does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the federal funds rate will be the arithmetic mean of the rates for the last transaction in overnight, U.S. dollar federal funds arranged, before 9:00 A.M., New York City time, on the relevant interest determination date, by three leading brokers of U.S. dollar federal funds transactions in New York City selected by the calculation agent.

If fewer than three brokers selected by the calculation agent are quoting as described in the prior paragraph, the federal funds rate in effect for the new interest period will be the federal funds rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

LIBOR Notes

If you purchase a LIBOR note, your note will bear interest at a base rate equal to the London interbank offered rate for deposits in U.S. dollars or any other index currency, which is referred to as LIBOR , as specified in your pricing supplement. In addition, the applicable LIBOR base rate will be adjusted by the spread or spread multiplier, if any, specified in your pricing supplement. LIBOR will be determined in the following manner:

LIBOR will be either:

the offered rate appearing on the ***Moneyline Telerate LIBOR page***; or

the arithmetic mean of the offered rates appearing on the ***Reuters screen LIBOR page*** unless that page by its terms cites only one rate, in which case that rate;

in either case, as of 11:00 A.M., London time, on the relevant LIBOR interest determination date, for deposits of the relevant index currency having the relevant index maturity beginning on the relevant interest reset date. Your pricing supplement will indicate the index currency, the index maturity and the reference page that apply to your LIBOR note. If no reference page is specified in your pricing supplement, Moneyline Telerate LIBOR page will apply to your LIBOR note.

If Moneyline Telerate LIBOR page applies and the rate described above does not appear on that page, or if Reuters screen LIBOR page applies and fewer than two of the rates described above appear on that page or no rate appears on any page on which only one rate normally appear, then LIBOR will be determined on the basis of the rates, at approximately 11:00 A.M., London time, on the relevant LIBOR interest determination date, at which deposits of the following kind are offered to prime banks in the London interbank market by four major banks in that market selected by the calculation agent: deposits of the index

currency having the relevant index maturity, beginning on the relevant interest reset date, and in a ***representative amount***. The calculation agent will request the principal London office of each of these banks to provide a quotation of its rate. If at least two quotations are provided, LIBOR for the relevant LIBOR interest determination date will be the arithmetic mean of the quotations.

If fewer than two quotations are provided as described in the prior paragraph, LIBOR for the relevant LIBOR interest determination date will be the arithmetic mean of the rates for loans of the following kind to leading European banks quoted, at approximately 11:00 A.M., in the principal financial center for the country of the index currency, on that LIBOR interest determination date, by three major banks in that financial center selected by the calculation agent: loans of the index

currency having the relevant index maturity, beginning on the relevant interest reset date, and in a repr1">

Numerator for earnings per share net income	$ 5,161,950	$ 5,520,104	$ 10,535,475	$ 10,822,897
Denominator:				
Denominator for basic earnings per share weighted average shares	11,963,596	11,772,819	11,956,362	11,709,875
Effect of dilutive securities:				
Stock options and other share awards	218,469	254,642	232,939	291,914
Denominator for diluted earnings per share	12,182,065	12,027,461	12,189,301	12,001,789
Earnings per share:				
Basic	$ 0.43	$ 0.47	$ 0.88	$ 0.92
Diluted	$ 0.42	$ 0.46	$ 0.86	$ 0.90

For the three months ended September 30, 2012 and 2011, potential common stock from stock options totaling 124,200 and 55,000, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive. For the six months ended September 30, 2012 and 2011 potential common stock from stock options totaling 124,200 and 72,300, respectively, were not included in the diluted earnings per share calculation because their effect is anti-dilutive.

4. Finance Receivables

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

	September 30, 2012	March 31, 2012
Finance receivables, gross contract	$ 396,859,826	$ 388,988,355
Unearned interest	(113,155,760)	(110,651,966)
Finance receivables, net of unearned interest	283,704,066	278,336,389
Allowance for credit losses	(34,631,762)	(35,987,868)
Finance receivables, net	$ 249,072,304	$ 242,348,521

The terms of the Contracts range from 12 to 72 months and the Direct Loans range from 6 to 48 months. The Contracts bear a weighted average effective interest rate of 23.54% as of September 30, 2012 and 23.58% as of March 31, 2012.

Finance receivables consist of Contracts and Direct Loans, each of which comprises a portfolio segment. Each portfolio segment consists of smaller balance homogeneous loans which are collectively evaluated for impairment.

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

	Three months ended September 30,		Six months ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	$ 35,645,655	$ 36,534,432	$ 35,495,684	$ 35,895,449
Discounts acquired on new volume	2,843,382	2,966,280	5,944,320	6,076,091
Current period provision	293,618	109,516	214,400	108,708
Losses absorbed	(5,295,524)	(3,777,929)	(8,955,368)	(6,794,563)
Recoveries	763,687	542,240	1,552,303	1,105,108
Discounts accreted	(150,157)	(17,873)	(150,678)	(34,127)
Balance at end of period	$ 34,100,661	$ 36,356,666	$ 34,100,661	$ 36,356,666

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

The Company purchases Contracts from automobile dealers at a negotiated price that is less than the original principal amount being financed by the purchaser of the automobile. The Contracts are predominately for used vehicles. As of September 30, 2012, the average model year of vehicles collateralizing the portfolio was a 2005 vehicle. The average loan to value ratio, which expresses the amount of the Contract as a percentage of the average wholesale value of the automobile, is approximately 92%, at the time of purchase. 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, the wholesale value of the vehicle and competition in any given market. In making decisions regarding the purchase of a particular Contract the Company considers the following factors related to the borrower: place and length of residence; current and prior job status; history in making installment payments for automobiles; current income; and credit history. In addition, the Company examines its prior experience with Contracts purchased from the dealer from which the Company is purchasing the Contract, and the value of the automobile in relation to the purchase price and the term of the Contract. For allowance purposes, 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. Subsequent to the purchase, if the reserve for credit losses is determined to be inadequate for a static pool, then an additional charge to income through the provision is used to maintain adequate reserves based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, and current economic conditions. Such evaluation, considers among other matters, the estimated net realizable value 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 allowance for credit losses.

The average dealer discount associated with new volume for the three months ended September 30, 2012 and 2011 was 7.41% and 8.45%, respectively. The average dealer discount associated with new volume for the six months ended September 30, 2012 and 2011 was 7.83% and 8.48%, respectively.

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

	Three months ended September 30,		Six months ended September 30,	
	2012	2011	2012	2011
Balance at beginning of period	$ 561,803	$ 447,271	$ 492,184	$ 378,418
Current period provision	14,723	68,513	104,313	148,736
Losses absorbed	(49,103)	(32,648)	(74,195)	(51,094)
Recoveries	3,678	6,842	8,799	13,918
Balance at end of period	$ 531,101	$ 489,978	$ 531,101	$ 489,978

Direct Loans are 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 majority of Direct Loans are originated with current or former customers under the Company s automobile financing program. The typical Direct Loan represents a significantly better credit risk than our typical Contract due to the customer s historical payment history with the Company. In deciding whether or not to make a loan, the Company considers the individual s credit history, job stability, income and impressions created during a personal interview with a Company loan officer. Additionally, because most of 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. As of September 30, 2012, loans made by the Company pursuant to its Direct Loan program constituted

approximately 2% of the aggregate principal amount of the Company s loan portfolio.

Changes in the allowance for credit losses for both Contracts and Direct Loans were driven by current economic conditions and trends over several reporting periods which are useful in estimating future losses and overall portfolio performance.

The following table is an assessment of the credit quality by creditworthiness. A performing account is defined as an account that is less than 61 days past due. A non-performing account is defined as an account that is contractually delinquent for 61 days or more and the accrual of interest income is suspended. When an account is 120 days contractually delinquent, the account is written off.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

	September 30, 2012		September 30, 2011	
	Contracts	Direct Loans	Contracts	Direct Loans
Non-bankrupt accounts	$ 388,182,955	$ 8,069,213	$ 376,895,455	$ 5,721,768
Bankrupt accounts	600,969	6,689	402,341	
Total	$ 388,783,924	$ 8,075,902	$ 377,297,796	$ 5,721,768
Performing accounts	$ 383,165,822	$ 8,058,056	$ 373,068,536	$ 5,685,981
Non-performing accounts	5,618,102	17,846	4,229,260	35,787
Total	$ 388,783,924	$ 8,075,902	$ 377,297,796	$ 5,721,768

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

		Delinquencies			
Contracts	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
September 30, 2012	$ 388,783,924	$ 15,310,139	$ 3,879,087	$ 1,739,015	$ 20,928,241
		3.94%	1.00%	0.44%	5.38%
September 30, 2011	$ 377,297,796	$ 10,934,539	$ 3,188,022	$ 1,041,238	$ 15,163,799
		2.90%	0.84%	0.28%	4.02%

Direct Loans	**Gross Balance Outstanding**	**31 60 days**	**61 90 days**	**Over 90 days**	**Total**
September 30, 2012	$ 8,075,902	$ 94,770	$ 6,822	$ 11,024	$ 112,616
		1.17%	0.08%	0.14%	1.39%
September 30, 2011	$ 5,721,768	$ 22,229	$ 20,229	$ 15,558	$ 58,016
		0.39%	0.35%	0.27%	1.01%

The delinquency percentage for Contracts more than thirty days past due as of September 30, 2012 was 5.38% as compared to 4.02% as of September 30, 2011. The delinquency percentage for Direct Loans more than thirty days past due as of September 30, 2012 was 1.39% as compared to 1.01% as of September 30, 2011.

Finance receivables which are contractually delinquent for more than 60 day, are placed on nonaccrual status. Payments received on nonaccrual status finance receivables are applied to interest then principal. The Company resumes accrual of interest when the finance receivable is less than 60 days delinquent.

5. Line of Credit

The Company has an agreement with its consortium of lenders for a line of credit facility (the Line) for an amount of $150,000,000. The pricing of the Line, which expires on November 30, 2013, is 300 basis points above 30-day LIBOR with a 1% floor on LIBOR (4.00% at September 30, 2012 and March 31, 2012). Pledged as collateral for this credit facility are all of the assets of the Company. The outstanding amount of the credit facility was approximately $110,000,000 and $112,000,000 as of September 30, 2012 and March 31, 2012, respectively. The amount available under the line of credit was approximately $40,000,000 and $38,000,000 as of September 30, 2012 and March 31, 2012, respectively.

The facility requires compliance with certain financial ratios and covenants and satisfaction of specified financial tests, including maintenance of asset quality and performance tests. Dividends do not require consent in writing by the agent and majority lenders under the new facility as long as the Company is in compliance with a net income covenant. As of September 30, 2012, the Company was in full compliance with all debt covenants.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements

The Company utilizes interest rate swap agreements to manage exposure to variability in expected cash flows attributable to interst rate risk. The swap agreements, in effect, converts a portion of the LIBOR priced Line to a fixed rate, more closely matching the interest rate characteristics of finance receivables. As of March 31, 2012, the Company did not have any outstanding interest rate swap agreements. The following table summarizes the activity in the notional amounts of interest rate swap agreements:

	Six months ended September 30,	
	2012	**2011**
Notional amounts at April 1	$	$
New contracts	50,000,000	
Matured contracts		
Notional amounts at September 30	$ 50,000,000	$

On June 1, 2012, the Company entered into an interst rate swap agreement with an effective date of June 13, 2012, a notional amount of $25.0 million, a fixed rate of interest of 1.00% and a maturity date of June 13, 2017. On July 30, 2012, the Company entered into an interest rate swap agreement with an effective date of August 13, 2012 a notional amount of $25.0 million, a fixed rate of interest of 0.87% and a maturity date of August 14, 2017. The changes in the fair value of interest of interest rate swap agreements (unrealized gains and losses) are recorded in earnings. The Company does not use interest rate swap agreements for speculative purposes. Such instruments continue to be intended for use as ecomonic hedges.

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

	Three months ended September 30,		Six months ended September 30,	
	2012	**2011**	**2012**	**2011**
Periodic change in fair value of interest rate swap agreements	$ 474,019	$	$ 683,120	$
Periodic settlement differentials included in interest expense	77,606		93,424	
Total	$ 551,625	$	$ 776,544	$

The Company recorded realized losses from the swap agreement in the interest expense line item of the consolidated statement of income. The following table summarizes the variable rate (LIBOR) received and fixed rate paid under the swap agreement.

	Three months ended September 30,		Six months ended September 30,	
	2012	**2011**	**2012**	**2011**
Variable rate received	0.24%		0.24%	

Fixed rate paid	0.95%	0.96%

7. Fair Value Disclosures

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

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

7. Fair Value Disclosures (continued)

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

The Company estimates the fair value of interst rate swap agreements based on the estimated net present value of the future cash flows using a forward interest rate yield curve in effect as of the measurement period, adjusted for nonperformance risk, if any, including a quantitative and qualitative evaluation of both the Company s credit risk and the counterparty s credit risk. Accordingly, the Company classifies interest rate swap agreements as Level 2.

	Fair Value Measurement Using			
Description	Level 1	Level 2	Level 3	Fair Value
Interest rate swap agreements:				
September 30, 2012	$	$ 683,120	$	$ 683,120
March 31, 2012	$	$	$	$

Financial Instruments Not Measured at Fair Value

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

The carrying value of cash approximates the fair value due to the nature of these accounts.

Finance receivables, net approximates fair value based on the price paid to acquire indirect loans. The price paid reflects competitive market interest rates and purchase discounts for the Company s chosen credit grade in the economic environment. This market is highly liquid as the Company acquires individual loans on a daily basis from dealers. The initial terms of the Contracts range from 12 to 72 months. The initial terms of the Direct Loans range from 6 to 48 months. In addition, there have been minimal changes in interest rates and purchase discounts related to these types of loans. If liquidated outside of the normal course of business, the amount received may not be the carrying value.

The Line was amended within the quarter ended September 30, 2011. Based on current market conditions, any new or renewed credit facility would contain pricing that approximates the Company s current Line. Based on these market conditions, the fair value of the Line as of September 30, 2012 was estimated to be equal to the book value. The interest rate for the Line is a variable rate based on LIBOR pricing options.

	Fair Value Measurement Using			
Description	Level 1	Level 2	Level 3	Fair Value
Cash:				
September 30, 2012	$ 3,722,550	$	$	$ 3,722,550
March 31, 2012	$ 2,803,054	$	$	$ 2,803,054
Finance receivables:				
September 30, 2012	$	$	$ 249,072,000	$ 249,072,000
March 31, 2012	$	$	$ 242,350,000	$ 242,350,000

Line of credit:				
September 30, 2012	$	$ 110,000,000	$	$ 110,000,000
March 31, 2012	$	$ 112,000,000	$	$ 112,000,000

Assets and Liabilities Recorded at Fair Value on a Nonrecurring Basis

The Company may be required, from time to time, to measure certain assets and liabilities at fair value on a nonrecurring basis. The Company does not currently have any assets or liabilities measured at fair value on a nonrecurring basis.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Consolidated Financial Statements (Continued)

(Unaudited)

8. Recently Issued Accounting Standards

In May 2011, the FASB issued ASU No. 2011-04 Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs . which amends Topic 820 (Fair Value Measurement). ASU No. 2011-04 is intended to provide a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between U.S. GAAP and IFRS. The amendments in ASU No. 2011-04 include changes regarding how and when the valuation premise of highest and best use applies, the application of premiums and discounts, and new required disclosures. ASU No. 2011-04 is effective for the fiscal 2013 interim and annual periods. The adoption of ASU No. 2011-04 on April 1, 2012 did not have a material impact on our consolidated financial statements, but expanded our disclosures related to fair value measurements.

9. Cash Dividend

On May 2, 2012 the Board of Directors declared a quarterly dividend equal to $0.10 per common share, to be paid on June 6th to shareholders of record as of May 30, 2012. On August 7, 2012 the Board of Directors declared a quarterly dividend equal to $0.12 per common share, to be paid on September 6, 2012to shareholders of record as of August 30, 2012. On November 7, 2012 the Board of Directors declared a quarterly dividend equal to $.12 per common share, to be paid on December 6th to shareholders of record as of November 30, 2012.

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

Forward-Looking Information

This report on Form 10-Q contains various statements, other than those concerning historical information, that are based on management s beliefs and assumptions, as well as information currently available to management, and should be considered forward-looking statements. This notice is intended to take advantage of the safe harbor provided by the Private Securities Litigation Reform Act of 1995 with respect to such forward-looking statements. When used in this document, the words anticipate , estimate , expect , and similar expressions are intended to identify forward-looking statements. Although 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. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those anticipated, estimated or expected. Among the key factors that may have a direct bearing on the Company s operating results are fluctuations in the economy, the ability to access bank financing, the degree and nature of competition, demand for consumer financing in the markets served by the Company, the Company s products and services, increases in the default rates experienced on Contracts, adverse regulatory changes in the Company s existing and future markets, the Company s ability to expand its business, including its ability to 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 obligations to update any such forward looking statement. You should also consult factors described from time to time in the Company s filings made with the Securities and Exchange Commission, including its reports on Forms 10-K, 10-Q, 8-K and annual reports to shareholders.

Critical Accounting Policy

The Company s critical accounting policy relates to the allowance for credit losses. It is based on management s opinion of an amount that is adequate to absorb losses in the existing portfolio. The allowance for credit losses is established through allocations of dealer discount and a provision for losses based on management s evaluation of the risk inherent in the loan portfolio, the composition of the portfolio, and current economic conditions. Such evaluation, considers among other matters, the estimated net realizable value or the fair value of the underlying collateral, economic conditions, historical loan loss experience, management s estimate of probable credit losses and other factors that warrant recognition in providing for an adequate credit loss allowance.

Because of the nature of the customers under the Company s Contracts and its Direct Loans, 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 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 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 may 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.

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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 including fees, if any. The discount negotiated by the Company is a function of the credit quality of the customer, the wholesale value of the vehicle, and competition in any given market. The automotive dealer accepts these terms by executing a dealer agreement with the Company. For allowance purposes, the Company considers the entire amount of discount to be related to credit quality and is 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.

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.

Introduction

Consolidated net income decreased 5% to approximately $5.2 million for the three-month period ended September 30, 2012 as compared to $5.5 million for the corresponding period ended September 30, 2011. Diluted earnings per share decreased 9% to $0.42 as compared to $0.46 for the three months ended September 30, 2012 and September 30, 2011. Consolidated net income decreased 3% to approximately $10.5 million for the six-month period ended September 30, 2012 as compared to $10.8 million for the corresponding period ended September 30, 2011. Diluted earnings per share decreased 4% to $0.86 for the six months ended September 30, 2012 as compared to $0.90 for the six months ended September 30, 2011.

The revenue increase for the three months ended September 30, 2012 was more than offset by a non-cash charge related to interest rate swap agreements (mark-to-market) and an increase in operating expenses as a percentage of net finance receivables. The increase in operating expenses were mainly attributable to the opening of three new branch locations.

The Company s software subsidiary, Nicholas Data Services, did not contribute significantly to consolidated operations in the three or six months ended September 30, 2012 or 2011.

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Portfolio Summary	Three months ended September 30, 2012	2011	Six months ended September 30, 2012	2011
Average finance receivables, net of unearned interest (1)	$ 282,424,703	$ 272,906,536	$ 281,087,493	$ 271,022,679
Average indebtedness (2)	$ 109,000,000	$ 116,505,921	$ 109,875,000	$ 117,002,960
Interest and fee income on finance receivables (3)	$ 17,761,998	$ 17,199,730	$ 35,032,086	$ 33,823,318
Interest expense	1,250,231	1,236,893	2,442,371	2,465,871
Net interest and fee income on finance receivables	$ 16,511,767	$ 15,962,837	$ 32,589,715	$ 31,357,447
Weighted average contractual rate (4)	23.48%	23.94%	23.64%	23.91%
Average cost of borrowed funds (2)	4.59%	4.25%	4.45%	4.22%
Gross portfolio yield (5)	25.16%	25.21%	24.93%	24.96%
Interest expense as a percentage of average finance receivables, net of unearned interest	1.77%	1.81%	1.74%	1.82%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	0.44%	0.26%	0.23%	0.19%
Net portfolio yield (5)	22.95%	23.14%	22.96%	22.95%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	10.31%	9.85%	10.20%	9.85%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	12.64%	13.29%	12.76%	13.10%
Write-off to liquidation (8)	7.54%	5.93%	6.25%	5.34%
Net charge-off percentage (9)	6.39%	4.74%	5.23%	4.18%

Note: All three and six month key performance indicators expressed as percentages have been annualized.

(1) Average finance receivables, net of unearned interest, represents the average of gross finance receivables, less unearned interest throughout the period.

(2) Average indebtedness represents the average outstanding borrowings under the Line. Average cost of borrowed funds represents interest expense as a percentage of average indebtedness.

(3) Interest and fee income on finance receivables does not include revenue generated by Nicholas Data Services, Inc., (NDS) the wholly-owned software subsidiary of Nicholas Financial, Inc.

(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) Administrative expenses included in the calculation above are net of administrative expenses associated with NDS which approximated $50,000 and $53,000 during the three-month periods ended September 30, 2012 and 2011 and $117,000 and $113,000 during the six-month periods ended September 30, 2012 and 2011, respectively.

(7) Pre-tax yield represents net portfolio yield minus administrative 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.

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Three months ended September 30, 2012 compared to three months September 30, 2011

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 3% to approximately $17.8 million for the three-month period ended September 30, 2012 from $17.2 million for the corresponding period ended September 30, 2011. Average finance receivables, net of unearned interest equaled approximately $282.4 million for the three-month period ended September 30, 2012, an increase of 3% from $272.9 million for the corresponding period ended September 30, 2011. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and also the opening of new branch locations (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 4% to approximately $396.9 million as of September 30, 2012, from $383.0 million as of September 30, 2011. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 25.16% for the three-month period ended September 30, 2012 compared to 25.21% for the three-month period ended September 30, 2011. The net portfolio yield decreased to 22.95% for the corresponding period ended September 30, 2012 from 23.14% for the three-month period ended September 30, 2011. The gross portfolio yield decreased slightly due to a decrease of the weighted APR earned on finance receivables. The net portfolio yield decreased primarily due to an increase in the actual and expected net charge-offs and an increase in the provision for credit losses which are discussed below under Analysis of Credit Losses.

Marketing, Salaries, Employee Benefits, Depreciation and Administrative Expenses

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $7.3 million for the three-month period ended September 30, 2012 from approximately $6.7 million for the corresponding period ended September 30, 2011. The increase of 9% was primarily attributable to new branch locations. The Company operated 63 and 58 branch locations as of September 31, 2012 and 2011, respectively. The Company opened additional branches and increased average headcount to 309 for the three-month period ended September 30, 2012 from 288 for the three-month period ended September 30, 2011. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, increased to 10.31% for the three-month period ended September 30, 2012 from 9.85% for the three-month period ended September 30, 2011.

Interest Expense

Interest expense increased to approximately $1.3 million for the three-month period ended September 30, 2012 from $1.2 million for the three-month period ended September 30, 2011. One interest rate swap was entered into during the second quarter ended September 30, 2012. The following table summarizes the Company s average cost of borrowed funds:

	Three months ended September 30,	
	2012	2011
Variable interest under the line of credit facility	0.59%	0.47%
Settlements under interest rate swap agreements	0.28%	0.00%
Credit spread under the line of credit facility	3.72%	3.78%
Average cost of borrowed funds	4.59%	4.25%

The Company s average cost of funds increased due to unused line fees and the costs associated with settlements under the interest rate swap agreement during the three months ended September 30, 2012.

The weighted average notional amount of interest rate swap agreements was $38.3 million at a weighted average fixed rate of 0.95% for the three months ended September 30, 2012. For further discussions regarding the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements .

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Six months ended September 30, 2012 compared to six months ended September 30, 2011

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 4% to approximately $35.0 million for the six-month period ended September 30, 2012 from $33.8 million for the corresponding period ended September 30, 2011. Average finance receivables, net of unearned interest equaled approximately $281.1 million for the six-month period ended September 30, 2012, an increase of 4% from $271.0 million for the corresponding period ended September 30, 2011. The primary reason average finance receivables, net of unearned interest, increased was the increase in the receivable base of several existing branches in younger markets and also the opening of new branch locations (see Contract Procurement and Loan Origination below). The gross finance receivable balance increased 4% to approximately $396.9 million as of September 30, 2012, from $383.0 million as of September 30, 2011. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 24.93% for the six-month period ended September 30, 2012 from 24.96% for the six-month period ended September 30, 2011. The net portfolio yield remained relatively flat at 22.96% for the period ended September 30, 2012 and 22.95% for the six-month period ended September 30, 2011. The gross portfolio yield decreased primarily due to a slight decrease in the weighted APR earned on finance receivables.

Marketing, Salaries, Employee Benefits, Depreciation and Administrative Expenses

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $14.5 million for the six-month period ended September 30, 2012 from approximately $13.5 million for the corresponding period ended September 30, 2011. The increase of 7% was primarily attributable to new branch locations. The Company opened additional branches and increased average headcount to 303 for the three-month period ended September 30, 2012 from 293 for the three-month period ended September 30, 2011. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 10.20% for the six-month period ended September 30, 2012 from 9.85% for the six-month period ended September 30, 2011.

Interest Expense

Interest expense decreased to approximately $2.4 million for the six-month period ended September 30, 2012 from $2.5 million for the six-month period ended September 30, 2011. The following table summarizes the Company s average cost of borrowed funds for the six-month period ended September 30:

	Six months ended September 30,	
	2012	**2011**
Variable interest under the line of credit facility	0.55%	0.44%
Settlements under interest rate swap agreements	0.17%	0.00%
Credit spread under the line of credit facility	3.73%	3.78%
Average cost of borrowed funds	4.45%	4.22%

The Company s average cost of funds increased due to unused line fees and the costs associated with settlements under the interest rate swap agreement during the six months ended September 30, 2012.

The weighted average notional amount of interest rate swap agreements was $20.7 million at a weighted average fixed rate of 0.96% for the six months ended September 30, 2012. For further discussions regarding the effect of interest rate swap agreements see note 6 Interest Rate Swap Agreements .

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Contract Procurement

The Company purchases Contracts in the fifteen states listed in the table below. The Contracts purchased by the Company are predominately for used vehicles; for the three-month period ended September 30, 2012 and 2011, less than 2% were for new vehicles.

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

	Three months ended September 30,		Six months ended September 30,	
State	**2012**	**2011**	**2012**	**2011**
FL	$ 11,905,243	$ 10,621,214	$ 22,978,636	$ 22,032,974
GA	4,092,085	3,614,109	8,013,127	7,899,035
NC	4,255,512	3,139,984	7,541,812	6,728,124
SC	1,116,343	561,702	1,773,212	1,291,773
OH	5,438,733	4,652,242	10,789,244	9,258,582
MI	1,067,327	1,563,293	2,147,595	3,095,815
VA	1,368,775	734,582	2,563,564	1,613,656
IN	2,096,014	2,541,495	4,009,700	4,492,023
KY	2,002,252	2,170,369	4,309,158	4,454,972
MD	732,360	314,824	1,110,605	740,466
AL	1,227,541	1,793,660	2,981,305	3,436,001
TN	1,403,082	1,326,270	2,767,160	2,439,813
IL	1,008,105	856,456	2,175,203	1,656,376
MO	1,174,734	1,081,322	2,775,180	2,182,535
KS	355,894	121,967	540,431	233,784
Total	$ 39,244,000	$ 35,093,489	$ 76,475,932	$ 71,555,929

	Three months ended September 30,		Six months ended September 30,	
Contracts	**2012**	**2011**	**2012**	**2011**
Purchases	$ 39,244,000	$ 35,093,489	$ 76,475,932	$ 71,555,929
Weighted APR	23.31%	23.83%	23.48%	23.80%
Average discount	7.41%	8.45%	7.83%	8.48%
Weighted average term (months)	49	49	49	49
Average loan	$ 10,352	$ 9,922	$ 10,136	$ 9,900
Number of Contracts	3,791	3,537	7,545	7,228

Loan Origination

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

	Three months ended September 30,		Six months ended September 30,	
Direct Loans Originated	**2012**	**2011**	**2012**	**2011**
Originations	$ 2,246,485	$ 1,634,237	$ 4,300,970	$ 2,948,003
Weighted APR	26.34%	26.36%	26.36%	26.57%
Weighted average term (months)	28	26	28	25
Average loan	$ 3,338	$ 3,043	$ 3,314	$ 2,954
Number of loans	673	537	1,298	998

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Analysis of Credit Losses

As of September 30, 2012, the Company had 1,305 active static pools. The average pool upon inception consisted of 61 Contracts with aggregate finance receivables, net of unearned interest, of approximately $606,000.

The Company anticipates losses absorbed as a percentage of liquidation will be in the 8%-12% range during the 3rd quarter of this fiscal year and will be in the range of 5%-9% during the 4th quarter of this fiscal year; however, no assurances can be given that the actual losses absorbed may not be higher as a result of continued aggressive competition or further economic weakness. The longer-term outlook for portfolio performance will depend largely on the competition. Other indicators include the overall economic conditions, the unemployment rate, and the price of oil which impacts the cost of gasoline, food and many other items used or consumed by the average person. Also, the Company s ability to monitor, manage and implement its underwriting philosophy in additional geographic areas as it strives to continue its expansion will impact future portfolio performance. The Company does not believe there have been any significant changes in loan concentrations or terms of Contracts purchased during the three or six months ended September 30, 2012.

The provision for credit losses increased to approximately $308,000 from approximately $178,000 for the three months ended September 30, 2012 and 2011, respectively. The provision for credit losses increased to approximately $319,000 from approximately $257,000 for the six months ended September 30, 2012 and 2011, respectively.

The Company s losses as a percentage of liquidation increased to 7.54% from 5.93% for the three months ended September 30, 2012 and 2011, respectively. The Company s losses as a percentage of liquidation increased to 6.25% and 5.43% for the six months ended September 30, 2012 and 2011, respectively. During the current periods, static pools originated during fiscal 2012 and 2013, while still performing at acceptable net charge-off levels, have experienced losses higher than static pools originated in previous years. The performance of the more recently originated pools is driven primarily by increased competition in all markets that the Company presently operates in.

In periods of increased competition, given efforts to maintain volume, advance rates are typically higher. In addition credit quality, while acceptable under Company guidelines, is typically lower, as more lenders seek to originate and purchase Contracts. Accordingly, delinquencies and losses typically increase in such periods.

In the face of increased pricing competition the average dealer discount associated with new volume for the three months ended September 30, 2012 decrease to 7.41% compared to 8.45% for the three months ended September 30, 2011. The average dealer discount associated with new volume for the six months ended September 30, 2012 decreased to 7.83% compared to 8.48% for the six months ended September 30, 2011. A static pool retains the discount as a reserve for credit losses. Subsequent to the purchase, if the reserve for credit losses established by the discount is determined to be inadequate for a static pool, additional charges to income through the provision are used to reestablish adequate reserves.

The Company has also experienced increased losses in part due to an decrease in auction proceeds from repossessed vehicles. These proceeds are dependent upon several variables including the general market for repossessed vehicles. During the three months ended September 30, 2012 and 2011, auction proceeds from the sale of repossessed vehicles averaged approximately 51% and 57%, respectively of the related principal balance. The reduction of proceeds recovered increase the severity of each loss.

Consequently, if these trends continue, the Company would expect the provision for credit losses to increase for recent and future static pools.

The Company believes delinquency trends over several reporting periods are useful in estimating future losses and overall portfolio performance. The Company also estimates future portfolio performance by considering various factors, the most significant of which are described as follows. The Company analyzes historical static pool performance for each branch location when determining appropriate reserve levels. Additionally, the Company utilizes results from internal branch audits as an indicator of future static pool performance. The Company also considers such things as the current unemployment rate in markets the Company operates in, the percentage of voluntary repossessions as compared to prior periods, the percentage of bankruptcy filings as compared to prior periods and other leading economic indicators. Historically, delinquencies are higher for the December quarter end than other quarterly periods in a fiscal year. The delinquency percentage for Contracts more than thirty days past due as of September 30, 2012 was 5.38% as compared to 4.02% as of September 30, 2011. This increase is primarily a result of increased competition in all markets that the Company presently operates in. The delinquency percentage for Direct Loans more than thirty days past due as of September 30, 2012 was 1.39% as compared to 1.01% as of September 30, 2011. See note 4 Finance Receivables for changes in allowance for credit losses, credit quality and delinquencies. Such increases were contemplated in determining the appropriate reserve levels.

Recoveries as a percentage of charge-offs increased to approximately 15.78% for the three months ended September 30, 2012 from approximately 15.22% for the three months ended September 30, 2011. Recoveries as a percentage of charge-offs increased to approximately 18.63% for the three months ended September 30, 2012 from approximately 17.23% for the six months ended September 30, 2011. Historically, recoveries as a percentage of charge-off s fluctuate from period to period, and the Company does not attribute this increase to any particular change in operational strategy or economic event.

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In accordance with our policies and procedures, certain borrowers qualify for, and the Company offers, one-month principal payment deferrals on Contracts and Direct Loans. For the three months ended September 30, 2012 and September 30, 2011 the Company granted deferrals to approximately 5.58% and 6.67%, respectively, of total Contracts and Direct Loans. For the six months ended September 30, 2012 and September 30, 2011 the Company granted deferrals to approximately 10.76% and 11.54%, respectively, of total Contracts and Direct Loans. The number of deferrals is influenced by portfolio performance, general economic conditions and the unemployment rate.

Income Taxes

Driven by decreases in operating income, the provision for income taxes decreased to approximately $3.2 million for the three months ended September 30, 2012 from approximately $3.5 million for the three months ended September 30, 2011. The Company s effective tax rate decreased slightly to 38.60% for the three months ended September 30, 2012 from 38.78% for the three months ended September 30, 2011. The provision for income taxes decreased to approximately $6.6 million for the six months ended September 30, 2012 from approximately $6.8 million for the six months ended September 30, 2011. The Company s effective tax rate decreased to 38.54% for the six months ended September 30, 2012 from 38.67% for the six months ended September 30, 2011.

Liquidity and Capital Resources

The Company s cash flows are summarized as follows:

	Six months ended September 30,	
	2012	2011
Cash provided by (used in):		
Operating activities	$ 12,736,379	$ 9,967,412
Investing activities (primarily purchase of Contracts)	(7,454,040)	(7,642,325)
Financing activities	(4,362,843)	(1,622,934)
Net increase in cash	$ 919,496	$ 702,153

The Company s primary use of working capital during the six months ended September 30, 2012, was the funding of the purchase of Contracts which are financed substantially through cash from principal payments received and cash from operations. The Line is secured by all of the assets of the Company and has a maturity date of November 30, 2013. The Company may borrow up to $150.0 million. Borrowings under the Line may be under various LIBOR pricing options plus 300 basis points with a 1% floor on LIBOR. As of September 30, 2012, the amount outstanding under the Line was approximately $110.0 million, and the amount available under the Line was approximately $40.0 million.

The Company will continue to depend on the availability of the Line, together with cash from operations, to finance future operations. Amounts outstanding under the Line have decreased by approximately $2.0 million during the six months ended September 30, 2012. The decrease of the Line is principally related to the fact that cash received from operations exceeded cash needed to fund new contracts. 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.

The Line requires compliance with certain debt covenants including financial ratios, asset quality and other performance tests. The Company is currently in compliance with all of its debt covenants but, during the current economic slowdown, a breach of one or more of these covenants could occur prior to the maturity date of the Line, which is November 30, 2013. The Company s consortium of lenders could place the Company in default if certain covenants were breached and take one or more of the following actions: increase the Company s borrowing costs; restrict the Company s ability to obtain additional borrowings under the Line; accelerate all amounts outstanding under the Line; or enforce its interests against collateral securing the Line. The Company believes its lenders will continue to allow it to operate in the event of a condition of default; however no assurance can be given that this would occur.

For the past 4 quarters the Company has declared a cash dividend to shareholders. On May 2, 2012 the Board of Directors declared a quarterly dividend equal to $0.10 per common share, to be paid on June 6th to shareholders of record as of May 30, 2012. On August 7, 2012 the Board of Directors declared a quarterly dividend equal to $0.12 per common share, to be paid on September 6, 2012 to shareholders of record as of August 30, 2012. On November 7, 2012 the Board of Directors declared a quarterly dividend equal to $.12 per common share, to be paid on

December 6th to shareholders of record as of November 30th.

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Contractual Obligations

The following table summarizes the Company s material obligations as of September 30, 2012.

	Payments Due by Period				
	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Operating leases	$ 2,842,677	$ 1,458,558	$ 777,078	$ 367,575	$ 239,466
Line of credit	110,000,000		110,000,000		
Interest on Line[1]	5,710,507	4,895,000	815,507		
Total	$ 118,553,184	$ 6,353,558	$ 111,592,585	$ 367,575	$ 239,466

[1] Interest on outstanding borrowings under the Line as of September 30, 2012, is based on an effective interest rate of 4.45% and the estimated effect of the interest rate swap settlement at September 30, 2012. The effective interest rate used in the above table does not contemplate the possibility of entering into interest rate swap agreements in the future.

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Future Expansion

The Company currently operates a total of sixty-three branch locations in fifteen states, including nineteen in Florida; eight in Ohio; six in North Carolina and Georgia; three in Kentucky, Indiana, Missouri and Alabama; two in Virginia, Michigan, Tennessee, Illinois, and South Carolina; and one each in Maryland, and Kansas. Each office is budgeted (size of branch, number of employees and location) to handle up to 1,000 accounts and up to $7.5 million in gross finance receivables. To date, fourteen of our branches meet this capacity. The Company continues to evaluate additional markets for future branch locations, and subject to market conditions, would expect to open additional branch locations during fiscal 2013. The Company remains open to acquisitions should an opportunity present itself.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to the Company s operations result primarily from changes in interest rates. The Company does not engage in speculative or leveraged transactions, nor does it hold or issue financial instruments for trading purposes.

Interest rate risk

Management s objective is to minimize the cost of borrowing through an appropriate mix of fixed and floating rate debt. Derivative financial instruments, such as interest rate swap agreements, may be used for the purpose of managing fluctuating interest rate exposures that exist from ongoing business operations. The Company does not use interest rate swap agreements for speculative purposes.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q, the Company s management evaluated, with the participation of the Company s President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, the effectiveness of the design and operation of the Company s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the President and Chief Executive Officer and the Senior Vice President and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of the date of such evaluation to ensure that material information relating to the Company, including its consolidated subsidiaries, was made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in internal controls. There have been no changes in the Company s internal control over financial reporting that occurred during the Company s last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I Item 1A. Risk Factors in the Company s Annual Report on Form 10-K for the year ended March 31, 2012, which could materially affect our business, financial condition or future results. The risks described in the Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that the Company currently deems to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

ITEM 6. EXHIBITS

See exhibit index following the signature page.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

	NICHOLAS FINANCIAL, INC.
	(Registrant)
Date: November 9, 2012	/s/ Peter L. Vosotas Peter L. Vosotas Chairman of the Board, President, Chief Executive Officer and Director
Date: November 9, 2012	/s/ Ralph T. Finkenbrink Ralph T. Finkenbrink Senior Vice President, Chief Financial Officer and Director

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EXHIBIT INDEX

Exhibit No.	Description
10.9	Form of Dealer Agreement and Schedule thereto listing dealers that are parties to such agreements
31.1	Certification of the President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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
101.INS**	XBRL Instance Document
101.SCH**	XBRL Taxonomy Extension Schema Document
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB**	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document

* This certification accompanies the Quarterly Report on Form 10-Q and is not filed as part of it.

** Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.