NICHOLAS FINANCIAL INC
Form 10-Q
August 09, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED June 30, 2011

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM _______ TO _______.

Commission file number: 0-26680

NICHOLAS FINANCIAL, INC.

(Exact Name of Registrant as Specified in its Charter)

British Columbia, Canada	**8736-3354**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
2454 McMullen Booth Road, Building C	
Clearwater, Florida	**33759**
(Address of Principal Executive Offices)	**(Zip Code)**

(727) 726-0763

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

As of July 27, 2011, the registrant had 11,956,335 shares of common stock outstanding.

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NICHOLAS FINANCIAL, INC.

FORM 10-Q

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

	June 30, 2011 (Unaudited)	March 31, 2011
Assets		
Cash	$ 2,988,840	$ 2,017,540
Finance receivables, net	234,687,519	230,163,854
Assets held for resale	1,409,287	1,055,140
Prepaid expenses and other assets	866,525	680,615
Property and equipment, net	820,277	771,311
Deferred income taxes	9,127,932	8,954,665
Total assets	$ 249,900,380	$ 243,643,125
Liabilities and shareholders equity		
Line of credit	$ 116,000,000	$ 118,000,000
Drafts payable	1,545,965	1,878,609
Accounts payable and accrued expenses	6,845,753	7,209,387
Income taxes payable	3,109,893	233,754
Deferred revenues	1,072,457	1,107,907
Total liabilities	128,574,068	128,429,657
Shareholders equity		
Preferred stock, no par: 5,000,000 shares authorized; none issued		
Common stock, no par: 50,000,000 shares authorized; 11,914,255 and 11,806,660 shares issued and outstanding, respectively	27,147,782	26,337,731
Retained earnings	94,178,530	88,875,737
Total shareholders equity	121,326,312	115,213,468
Total liabilities and shareholders equity	$ 249,900,380	$ 243,643,125

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Income

(Unaudited)

	Three months ended June 30, 2011	Three months ended June 30, 2010
Revenue:		
Interest and fee income on finance receivables	$ 16,623,588	$ 14,942,905
Sales	10,717	9,242
	16,634,305	14,952,147
Expenses:		
Cost of sales	2,756	2,906
Marketing	298,796	318,659
Salaries and employee benefits	4,391,810	3,933,511
Administrative	1,929,383	1,927,006
Provision for credit losses	79,415	1,595,661
Depreciation	72,541	67,093
Interest expense	1,228,978	1,539,373
Change in fair value of interest rate swaps		(244,365)
	8,003,679	9,139,844
Operating income before income taxes	8,630,626	5,812,303
Income tax expense	3,327,833	2,236,465
Net income	$ 5,302,793	$ 3,575,838
Earnings per share:		
Basic	$ 0.46	$ 0.31
Diluted	$ 0.44	$ 0.30

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Three months ended June 30,	
	2011	**2010**
Cash flows from operating activities		
Net income	$ 5,302,793	$ 3,575,838
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	72,541	67,093
Gain on sale of property and equipment	(2,526)	
Provision for credit losses	79,415	1,595,661
Deferred income taxes	(173,267)	(465,247)
Share-based compensation	57,765	153,705
Change in fair value of interest rate swaps		(244,365)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(185,910)	222,784
Accounts payable and accrued expenses	(363,634)	1,196,141
Income taxes payable	2,876,139	1,808,505
Deferred revenues	(35,450)	(18,728)
Net cash provided by operating activities	7,627,866	7,891,387
Cash flows from investing activities		
Purchase and origination of finance contracts	(33,436,582)	(32,546,937)
Principal payments received	28,833,502	22,279,973
Increase in assets held for resale	(354,147)	(116,092)
Purchase of property and equipment	(138,131)	(65,780)
Proceeds from sale of property and equipment	19,150	
Net cash used in investing activities	(5,076,208)	(10,448,836)
Cash flows from financing activities		
Net (repayment) proceeds from line of credit	(2,000,000)	2,747,146
(Decrease) increase in drafts payable	(332,644)	494,408
Proceeds from exercise of stock options	529,826	48,170
Excess tax benefits from exercise of stock options and issuance of performance share awards	222,460	55,158
Net cash (used) provided by financing activities	(1,580,358)	3,344,882
Net increase in cash	971,300	787,433
Cash, beginning of period	2,017,540	1,533,894
Cash, end of period	$ 2,988,840	$ 2,321,327

See accompanying notes.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated balance sheet as of March 31, 2011, which has been derived from audited financial statements, and the accompanying unaudited interim condensed consolidated financial statements of Nicholas Financial, Inc. (including its subsidiaries, the Company) have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information and with the instructions to Form 10-Q pursuant to the Securities and Exchange Act of 1934, as amended in Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements, although the Company believes that the disclosures made are adequate to ensure the information is not misleading. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending March 31, 2012. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and accompanying notes thereto included in the Company s Annual Report on Form 10-K for the year ended March 31, 2011 as filed with the Securities and Exchange Commission on June 14, 2011. The March 31, 2011 condensed consolidated balance sheet included herein has been derived from the March 31, 2011 audited consolidated balance sheet included in the aforementioned Form 10-K.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for credit losses on finance receivables, and the net realizable value of assets held for resale.

2. Revenue Recognition

Finance receivables consist of automobile finance installment contracts (Contracts) and direct consumer loans (direct loans). Interest income on finance receivables is recognized using the interest method. Accrual of interest income on finance receivables is suspended when a loan is contractually delinquent for 60 days or more or the collateral is repossessed, whichever is earlier.

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

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

The Company s net fees charged for processing a loan are recognized as an adjustment to the yield and are amortized over the life of the loan using the interest method.

The Company attributes its entire dealer discount to a reserve for credit losses. 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 paid for the Contract. After the analysis of purchase date accounting is complete, any uncollectable amounts would be contemplated in estimating the allowance for loan losses.

Sales relate principally to telephone support agreements and the sale of business forms to small businesses located primarily in the Southeast United States. The aforementioned sales of the Nicholas Data Services, Inc. subsidiary, (NDS) represent less than 1% of the Company s consolidated revenues.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Earnings Per Share

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

	Three months ended June 30,	
	2011	2010
Numerator for earnings per share net income	$ 5,302,793	$ 3,575,838
Denominator:		
Denominator for basic earnings per share weighted average shares	11,651,295	11,555,212
Effect of dilutive securities:		
Stock options and other share awards	314,167	251,317
Denominator for diluted earnings per share	11,965,462	11,806,529
Earnings per share:		
Basic	$ 0.46	$ 0.31
Diluted	$ 0.44	$ 0.30

For the three months ended June 30, 2011 and 2010 potential common stock from stock options totaling 55,000 and 141,700, 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 consumer loans and are detailed as follows:

	June 30, 2011	March 31, 2011
Finance receivables, gross contract	$ 380,225,382	$ 372,950,283
Unearned interest	(108,556,160)	(106,512,562)
Finance receivables, net of unearned interest	271,669,222	266,437,721
Allowance for credit losses	(36,981,703)	(36,273,867)
Finance receivables, net	$ 234,687,519	$ 230,163,854

The terms of the finance receivables range from 12 to 72 months and the direct consumer loans range from 6 to 48 months. The receivables bear a weighted average interest rate of approximately 23.49% and 23.47% as of June 30, 2011 and March 31, 2011, respectively.

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 June 30,	
	2011	**2010**
Balance at beginning of period	$ 35,895,449	$ 30,408,578
Discounts acquired on new volume	3,109,811	3,166,797
Current period provision	(808)	1,600,837
Losses absorbed	(3,016,634)	(3,375,142)
Recoveries	562,868	579,612
Discounts accreted	(16,254)	(46,623)
Balance at end of period	$ 36,534,432	$ 32,334,059

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed 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 June 30, 2011, 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 value of the automobile, is approximately 90%. 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. 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 June 30, 2011 and 2010 was 8.51% and 8.91%, respectively.

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

	Three months ended June 30,	
	2011	**2010**
Balance at beginning of period	$ 378,418	$ 382,869
Current period provision	80,223	(5,176)
Losses absorbed	(18,446)	(50,052)
Recoveries	7,076	14,726
Balance at end of period	$ 447,271	$ 342,367

Direct loans are loans originated directly between the Company and the consumer. These loans are typically for amounts ranging from $1,000 to $8,000 and are generally secured by a lien on an automobile, watercraft or other permissible tangible personal property. The 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 June 30, 2011, loans made by the Company pursuant to its direct loan program constituted approximately 1% 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 Company s losses as a percentage of liquidation decreased to 4.72% from 6.49% for the three months ended June 30, 2011 and 2010, respectively. The Company has seen improvements in the quality of its Contracts due to reduced competition and an increased focus on collections. In addition, auction proceeds from repossessed vehicles reduce the amount of the write-off which drives down the write-off to liquidation percentage. During the three months ended June 30, 2011 and 2010 auction proceeds from the sale of repossessed vehicles averaged approximately 60% and 52%, respectively of the related principal balance.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

4. Finance Receivables (continued)

Recoveries as a percentage of charge-offs decreased to approximately 19.76% for the three months ended June 30, 2011 from approximately 20.12% for the three months ended June 30, 2010. Historically, recoveries as a percentage of charge-off s fluctuate from period to period, and the Company does not attribute this decrease to any particular change in operational strategy or economic event.

The following table is an assessment of the credit quality by creditworthiness. A performing account is defined as an account that is less than 60 days past due. A non-performing account is defined as an account that is contractually delinquent for 60 days or more and the accrual of interest income is suspended. When an account is 120 days contractually delinquent, the account is written off.

	June 30, 2011		**June 30, 2010**	
	Contracts	Direct Loans	Contracts	Direct Loans
Non-bankrupt accounts	$ 374,699,934	$ 5,151,901	$ 335,583,365	$ 4,845,178
Bankrupt accounts	373,547		309,216	
Total	$ 375,073,481	$ 5,151,901	$ 335,892,581	$ 4,845,178
Performing accounts	$ 372,179,788	$ 5,134,590	$ 332,409,180	$ 4,801,214
Non-performing accounts	2,893,693	17,311	3,483,401	43,964
Total	$ 375,073,481	$ 5,191,901	$ 335,892,581	$ 4,845,178

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

		Delinquencies			
Contracts	**Gross Balance Outstanding**	**30 59 days**	**60 89 days**	**90 + days**	**Total**
June 30, 2011	$ 375,073,481	$ 9,690,976	$ 2,286,127	$ 607,566	$ 12,584,669
		2.59%	0.60%	0.16%	3.35%
June 30, 2010	$ 335,892,581	$ 9,381,762	$ 2,728,739	$ 754,662	$ 12,865,163
		2.79%	0.81%	0.23%	3.83%

Direct Loans	**Gross Balance Outstanding**	**30 59 days**	**60 89 days**	**90 + days**	**Total**
June 30, 2011	$ 5,151,901	$ 53,069	$ 17,219	$ 92	$ 70,380
		1.03%	0.33%	0.00%	1.36%
June 30, 2010	$ 4,845,178	$ 68,939	$ 27,950	$ 16,014	$ 112,903
		1.42%	0.58%	0.33%	2.33%

The delinquency percentage for Contracts more than thirty days past due as of June 30, 2011 was 3.35% as compared to 3.83% as of June 30, 2010. The delinquency percentage for direct loans more than thirty days past due as of June 30, 2011 was 1.36% as compared to 2.33% as of June 30, 2010. The delinquency percentage decrease is attributable to allocating additional resources focused on collections.

When the Company receives a payment for a Contract that was contractually delinquent for more than 60 days, the payment is posted to the account. At the time of the payment, the interest that was paid is recorded as income by the Company and the Contract is no longer considered over 60 days contractually delinquent; therefore, the accruing of interest is resumed.

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

5. Line of Credit

The Company maintains a line of credit facility (the Line) up to $140,000,000, subject to formulas principally related to a percentage of eligible finance receivables, as defined. The pricing of the Line, which expires on November 30, 2011, is 300 basis points above 30-day LIBOR (4.00% and 4.00% at June 30, 2011 and March 31, 2011, respectively) with a 1% floor on LIBOR or at the prime rate. Prime rate borrowings are generally less than $5.0 million. The Company s cost of borrowed funds, which is based upon the interest rates charged under the Line and the effect of the interest rate swap agreements (see note 6), amounted to 4.18% and 5.69% for the three months ended June 30, 2011 and 2010, respectively.

Pledged as collateral for this credit facility are all of the assets of the Company. The outstanding amount of the credit facility was approximately $116,000,000 and $118,000,000 as of June 30, 2011 and March 31, 2011, respectively. The amount available under the line of credit was approximately $24,000,000 and $22,000,000 as of June 30, 2011 and March 31, 2011, 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 require consent in writing by the agent and majority lenders under the facility. As of June 30, 2011, the Company was in full compliance with all debt covenants.

6. Interest Rate Swap Agreements

As of June 30, 2011 and March 31, 2011, the Company did not have any outstanding interest rate swap agreements. Based on market conditions, the Company may or may not enter into new interest rate swap agreements during the current fiscal year. The swap agreements, in effect, converted a portion of the floating rate debt to a fixed rate, more closely matching the interest rate characteristics of finance receivables.

The following table summarizes the activity in the notional amounts of interest rate swaps:

	Three months ended June 30,	
	2011	**2010**
Notional amounts at April 1	$	$ 50,000,000
New contracts		
Matured contracts		(10,000,000)
Notional amounts at June 30	$	$ 40,000,000

These interest rate swaps were previously designated as cash flow hedges. Based on credit market events that transpired in October 2008, the Company made an economic decision to elect the prime rate pricing option available under the Line for the month of October 2008. As a result, the critical terms of the interest rate swaps and hedged interest payments were no longer identical and the Company undesignated its interest rate swaps as cash flow hedges. Consequently, beginning in October 2008 changes in the fair value of interest rate swaps (unrealized gains and losses) were recorded in earnings. Unrealized losses previously recorded in accumulated other comprehensive loss were reclassified into earnings as interest payments on the Line and affect earnings over the remaining term of the respective swap agreements. The Company did not use interest rate swaps for speculative purposes.

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

	Three months ended June 30,	
	2011	**2010**
Periodic change in fair value of interest rate swaps	$	$ 393,198
Losses reclassified from accumulated other comprehensive loss		(148,833)
		244,365
Periodic settlement differentials included in interest expense		(392,356)
Pre-tax loss recognized in income	$	$ (147,991)

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Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

6. Interest Rate Swap Agreements (continued)

The Company recorded net realized gains and losses from the swap agreements in the interest expense line item of the consolidated statement of income. The following table summarizes the average variable rates received and average fixed rates paid under the swap agreements.

	Three months ended June 30,	
	2011	2010
Average variable rate received		0.29%
Average fixed rate paid		3.89%

The following table reconciles net income with comprehensive income:

	Three months ended June 30,	
	2011	2010
Net income	$ 5,302,793	$ 3,575,838
Reclassification adjustment for loss included in net income, net of tax benefit of $56,980		91,853
Comprehensive income	$ 5,302,793	$ 3,667,691

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.

Assets and Liabilities Recorded at Fair Value on a Recurring Basis

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

Financial Instruments Not Measured at Fair Value

The Company s financial instruments, other than the interest rate swap agreements, consist of cash, finance receivables, accrued interest, the Line, and accounts payable. 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 indirect finance receivables range from 12 to 72 months. The initial terms of the direct finance receivables 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 signed within the fourth quarter of fiscal year ending March 31, 2010. 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 June 30, 2011 was estimated to be equal to the book value. Accrued interest is paid monthly. As a result of the short-term nature of this activity, the carrying value of the accrued interest approximates fair value. The interest rate for the line of credit is a variable rate based on LIBOR pricing options or at the prime rate.

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.

Nicholas Financial, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements (Continued)

(Unaudited)

8. Recently Issued Accounting Standards

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-02: Receivables (Topic 310) A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring in April 2011. The ASU s main objective is to provide greater transparency regarding whether additional guidance or clarification is needed to help creditors in determining whether a creditor has granted a concession and whether a debtor is experiencing financial difficulties for purposes of determining whether a restructuring constitutes a troubled debt restructuring. The guidance is effective for interim and annual periods beginning on or after June 15, 2011. The Company does not expect the guidance to have a material impact on the Company s consolidated financial statements.

The FASB issued ASU 2011-05: Comprehensive Income (Topic 220) Presentation of Comprehensive Income in June 2011. The ASU s main objective is to show the components of comprehensive income to provide a better understanding of the entity s activities. The guidance is effective for interim and annual periods beginning after December 15, 2011. Other than financial statement display, the update will have no impact on the reported amounts in the Company s consolidated financial statements.

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

Forward-Looking Information

This report on Form 10-Q contains various statements, other than those concerning historical information, that are based on management s beliefs and assumptions, as well as information currently available to management, and should be considered forward-looking statements. This notice is intended to take advantage of the safe harbor provided by the Private Securities Litigation Reform Act of 1995 with respect to such forward-looking statements. When used in this document, the words anticipate , estimate , expect , 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 loan program, the Company considers the establishment of adequate reserves for credit losses to be imperative. The Company segregates its Contracts into static pools for purposes of establishing reserves for losses. All Contracts purchased by a branch during a fiscal quarter comprise a static pool. The Company pools Contracts according to branch location because the branches purchase Contracts in different geographic markets. This method of pooling by branch and quarter allows the Company to evaluate the different markets where the branches operate. The pools also allow the Company to evaluate the different levels of customer income, stability, credit history, and the types of vehicles purchased in each market. Each such static pool consists of the Contracts purchased by a branch office during the fiscal quarter.

Contracts are purchased from many different dealers and are all purchased on an individual Contract by Contract basis. Individual Contract pricing is determined by the automobile dealerships and is generally the lesser of state maximum interest rates or the maximum interest rate 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.

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. The automotive dealer accepts these terms by executing a dealer agreement with the Company. 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 increased 47% to approximately $5.3 million for the three-month period ended June 30, 2011 as compared to $3.6 million for the corresponding period ended June 30, 2010. Diluted earnings per share increased 47% to $0.44 for the three months ended June 30, 2011 as compared to $0.30 for the three months ended June 30, 2010.

Earnings were favorably impacted primarily by an increase in average finance receivables, a decrease in operating expenses as a percentage of average finance receivables, net of unearned interest, and a decrease in the net charge off percentage and a reduction in the provision for credit losses. The Company s software subsidiary, Nicholas Data Services (NDS), did not contribute significantly to consolidated operations in the three months ended June 30, 2011 or 2010.

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Portfolio Summary	Three months ended June 30, 2011	2010
Average finance receivables, net of unearned interest (1) Average Net Finance Receivables (1)	$ 269,138,821	$ 238,314,417
Average indebtedness (2)	$ 117,500,000	$ 108,246,360
Interest and fee income on finance receivables (3)	$ 16,623,588	$ 14,942,905
Interest expense	1,228,978	1,539,373
Net interest and fee income on finance receivables	$ 15,394,610	$ 13,403,532
Weighted average contractual rate (4)	23.88%	23.54%
Average cost of borrowed funds (2)	4.18%	5.69%
Gross portfolio yield (5)	24.71%	25.08%
Interest expense as a percentage of average finance receivables, net of unearned interest	1.83%	2.58%
Provision for credit losses as a percentage of average finance receivables, net of unearned interest	0.12%	2.68%
Net portfolio yield (5)	22.76%	19.82%
Marketing, salaries, employee benefits, depreciation and administrative expenses as a percentage of average finance receivables, net of unearned interest (6)	9.86%	10.39%
Pre-tax yield as a percentage of average finance receivables, net of unearned interest (7)	12.90%	9.43%
Write-off to liquidation (8)	4.72%	6.49%
Net charge-off percentage (9)	3.62%	4.59%

Note: All three 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 $60,000 and $58,000 during the three-month periods ended June 30, 2011 and 2010, respectively.

(7) Pre-tax yield represents net portfolio yield minus operating expenses as a percentage of average finance receivables, net of unearned interest.

(8) Write-off to liquidation percentage is defined as net charge-offs divided by liquidation. Liquidation is defined as beginning receivable balance plus current period purchases minus voids and refinances minus ending receivable balance.

(9) Net charge-off percentage represents net charge-offs divided by average finance receivables, net of unearned interest, outstanding during the period.

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Three months ended June 30, 2011 compared to three months June 30, 2010

Interest Income and Loan Portfolio

Interest and fee income on finance receivables, predominately finance charge income, increased 11% to approximately $16.6 million for the three-month period ended June 30, 2011 from $14.9 million for the corresponding period ended June 30, 2010. Average finance receivables, net of unearned interest equaled approximately $269.1 million for the three-month period ended June 30, 2011, an increase of 13% from $238.3 million for the corresponding period ended June 30, 2010. 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 12% to approximately $380.2 million as of June 30, 2011, from $340.7 million as of June 30, 2010. The primary reason interest income increased was the increase in the outstanding loan portfolio. The gross portfolio yield decreased to 24.71% for the three-month period ended June 30, 2011 from 25.08% for the three-month period ended June 30, 2010. The net portfolio yield increased to 22.76% for the corresponding period ended June 30, 2011 from 19.82% for the three-month period ended June 30, 2010. The gross portfolio yield decreased primarily due to a lower weighted APR earned on finance receivables. The net portfolio yield increased primarily due to a decrease in the net charge-off percentage and a corresponding decrease in the provision for credit losses which are discussed below in Analysis of Credit Losses.

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

Marketing, salaries, employee benefits, depreciation and administrative expenses increased to approximately $6.7 million for the three-month period ended June 30, 2011 from approximately $6.2 million for the corresponding period ended June 30, 2010. The increase of 8% was primarily attributable to salaries expense. The Company opened additional branches and increased average headcount to 279 as of June 30, 2011 from 266 as of June 30, 2010. Marketing, salaries, employee benefits, depreciation, and administrative expenses as a percentage of finance receivables, net of unearned interest, decreased to 9.86% for the three-month period ended June 30, 2011 from 10.39% for the three-month period ended June 30, 2010.

Interest Expense

Interest expense decreased to approximately $1.2 million for the three-month period ended June 30, 2011 from $1.5 million for the three-month period ended June 30, 2010. All interest rate swaps agreements matured during fiscal 2011 and no new agreements were entered into. The following table summarizes the Company s average cost of borrowed funds:

	Three months ended June 30,	
	2011	**2010**
Variable interest under the line of credit facility	0.42%	0.53%
Settlements under interest rate swap agreements	0.00%	1.45%
Credit spread under the line of credit facility	3.75%	3.71%
Average cost of borrowed funds	4.17%	5.69%

The primary reason that the Company s average cost of funds decreased is attributed to the costs associated with settlements under interest rate swap agreements during the three months ended June 30, 2010.

The weighted average notional amount of interest rate swaps was $45.4 million at a weighted average fixed rate of 3.89% for the three months ended June 30, 2010. 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 periods ended June 30, 2011 and 2010, 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 June 30,	
State	**2011**	**2010**
FL	$ 11,411,760	$ 12,225,667
GA	4,284,926	4,029,421
NC	3,588,140	3,346,315
SC	730,071	489,859
OH	4,606,340	5,047,684
MI	1,532,522	1,438,492
VA	879,074	1,419,135
IN	1,950,528	2,244,967
KY	2,284,603	2,449,296
MD	425,642	457,618
AL	1,642,341	1,295,597
TN	1,113,543	1,281,751
IL	799,920	
MO	1,101,213	
KS	111,817	
Total	$ 36,462,440	$ 35,725,802

	Three months ended June 30,	
Contracts	**2011**	**2010**
Purchases	$ 36,462,440	$ 35,725,802
Weighted APR	23.78%	23.44%
Average discount	8.51%	8.91%
Weighted average term (months)	49	49
Average loan	$ 9,879	$ 9,902
Number of Contracts	3,691	3,608

Loan Origination

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

	Three months ended June 30,	
Direct Loans Originated	**2011**	**2010**
Originations	$ 1,313,766	$ 1,161,881
Weighted APR	26.84%	26.51%
Weighted average term (months)	25	24
Average loan	$ 2,850	$ 2,786
Number of loans	461	417

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Analysis of Credit Losses

As of June 30, 2011, the Company had 1,176 active static pools. The average pool upon inception consisted of 63 Contracts with aggregate finance receivables, net of unearned interest, of approximately $610,000.

The Company anticipates losses absorbed as a percentage of liquidation will be in the 5%-8% range during the remainder of the current fiscal year; however, no assurances can be given that the actual losses absorbed may not be higher as a result of further economic weakness. The longer-term outlook for portfolio performance will depend on 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 months ended June 30, 2011.

The provision for credit losses decreased in each period, largely due to the decrease in the net charge-off rate which was 3.62% for the three months ended June 30, 2011 as compared to 4.59% for the three months ended June 30, 2010. Also, the Company has experienced favorable variances between projected write offs and actual write-offs on certain pools which has resulted in an increase over expected cash inflows. This resulted in the reversal of provision on certain seasoned static pools which offset the provision on other static pools. As a result, the provision for credit losses was less than write offs during the current period.

In accordance with our policies and procedures, certain borrowers qualify for, and the Company offers, one-month principal payment deferrals on Contracts. For the three months ended June 30, 2011 and June 30, 2010 the Company granted deferrals to approximately 5.89% and 5.92%, respectively, of total Contracts. The number of deferrals is influenced by portfolio performance, general economic conditions and the unemployment rate.

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.

See note 4 Finance Receivables for changes in allowance, credit quality and delinquencies.

Income Taxes

Driven by increases in operating income, the provision for income taxes increased to approximately $3.3 million for the three months ended June 30, 2011 from approximately $2.2 million for the three months ended June 30, 2010. The Company s effective tax rate increased to 38.53% for the three months ended June 30, 2011 from 38.48% for the three months ended June 30, 2010.

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Liquidity and Capital Resources

The Company s cash flows are summarized as follows:

	Three months ended June 30,	
	2011	**2010**
Cash provided by (used in):		
Operating activities	$ 7,627,866	$ 7,891,387
Investing activities (primarily purchase of Contracts)	(5,076,208)	(10,448,836)
Financing activities	(1,580,358)	3,344,882
Net increase in cash	$ 971,300	$ 787,433

The Company s primary use of working capital during the three months ended June 30, 2011 was the funding of the purchase of Contracts which are financed substantially through borrowings under the Company s Line. During 2010, the Company increased the size of the Line and extended the maturity date to November 30, 2011. The Line is secured by all of the assets of the Company. The Company may borrow the lesser of $140.0 million or amounts based upon formulas principally related to a percentage of eligible finance receivables, as defined. Borrowings under the Line may be under various LIBOR pricing options plus 300 basis points with a 1% floor on LIBOR or at the prime rate. Prime rate based borrowings are generally less than $5.0 million. As of June 30, 2011, the amount outstanding under the Line was approximately $116.0 million, and the amount available under the Line was approximately $24.0 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 three months ended June 30, 2011. 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, 2011. 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.

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Future Expansion

The Company currently operates a total of fifty-seven branch locations in fourteen states, including nineteen in Florida, seven in Ohio, six in North Carolina, six in Georgia, three in Kentucky, three in Indiana, two in Virginia, two in Alabama, two in Michigan, two in Tennessee, two in South Carolina and one each in Maryland, Illinois, and Missouri. 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, eighteen of our branches have reached 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 2012. 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 swaps 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, 2011, 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: August 9, 2011	/s/ Peter L. Vosotas Peter L. Vosotas Chairman of the Board, President, Chief Executive Officer and Director
Date: August 9, 2011	/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.

yments for fiscal year 2014 will increase by 1.3% over fiscal year 2013 rates. The 1.3% increase consists of a 2.5% inflationary market basket update, offset by a 0.5% reduction for the productivity adjustment, and a 0.3% reduction to the market basket as defined by PPACA. LTACH payment rates will also be reduced by approximately 1.3% for the one-time budget neutrality adjustment factor and projected increases in estimated high cost outlier payments as compared to fiscal year 2013.

The LTACH fiscal year 2014 final rule also addressed the 25 Percent rule. Under the 25 Percent rule, if an LTACH admits more than 25% of its patients from a single acute care hospital, Medicare will pay the LTACH for cases in excess of the threshold at a lower rate comparable to the Inpatient Prospective Payment System (IPPS) that hospitals receive for general acute care. A statutory moratorium on the application of the 25 Percent rule was in place from December 2007 through December 2012. CMS stated its intention to extend the moratorium for fiscal year 2013, but allowed the policy to go into effect in fiscal year 2014. The imposition of the 25 Percent rule applied to all LTACHs beginning with their first cost reporting period beginning on or after October 1, 2013. As described below, recent legislation has suspended the 25 Percent rule for most LTACHs for two years.

On December 26, 2013, President Obama signed into law the Bipartisan Budget Act of 2013 (Public Law 113-67). This new law prevents a scheduled payment reduction for physicians and other practitioners who treat Medicare patients from taking effect on January 1, 2014. Included in the legislation are the following changes to LTACH reimbursement:

Medicare discharges from LTACHs will continue to be paid at full LTACH PPS rates if:

the patient spent at least three days in a short-term care hospital (STCH) intensive care unit (ICU) during a STCH stay that immediately preceded the LTACH stay, or

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the patient was on a ventilator for more than 96 hours in the LTACH (based on the MS-LTACH DRG assigned) and had a STCH stay immediately preceding the LTACH stay.

Also, the LTACH discharge cannot have a principal diagnosis that is psychiatric or rehabilitation.

All other Medicare discharges from LTACHs will be paid at a new site neutral rate, which is the lesser of:

the IPPS comparable per diem amount determined using the formula in the short-stay outlier regulation at 42 C.F.R. § 412.529(d)(4) plus applicable outlier payments, or

100% of the estimated cost of the services involved.

The above new payment policy will not be effective until LTACH cost reporting periods beginning on or after October 1, 2015, and the site neutral payment rate will be phased-in over three years.

For cost reporting periods beginning on or after October 1, 2015, discharges paid at the site neutral payment rate or by a Medicare Advantage plan (Part C) will be excluded from the LTACH average length-of-stay (ALOS) calculation.

For cost reporting periods beginning in fiscal year 2016 and later, CMS will notify LTACHs of their LTACH discharge payment percentage (i.e., the number of discharges not paid at the site neutral payment rate divided by the total number of discharges).

For cost reporting periods beginning in fiscal year 2020 and later, LTACHs with less than 50% of their discharges paid at the full LTACH PPS rates will be switched to payment under the IPPS for all discharges in subsequent cost reporting periods. However, CMS will set up a process for LTACHs to seek reinstatement of LTACH PPS rates for applicable discharges.

MedPAC will study the impact of the above changes on quality of care, use of hospice and other post-acute care settings, different types of LTACHs and growth in Medicare spending on LTACHs. MedPAC is to submit a report to Congress with any recommendations by June 30, 2019. The report is to also include MedPAC s assessment of whether the 25 Percent rule should continue to be applied.

25 Percent rule relief for freestanding LTACHs, HWHs and satellite facilities will be extended without interruption for cost reporting periods beginning on or after December 29, 2007 through December 28, 2016. Grandfathered HWHs will be permanently exempt from the 25 Percent rule. CMS must report to Congress by December 18, 2015 on whether the 25 Percent rule should continue to be applied.

The moratorium on new LTACH facilities and increases in LTACH beds will be renewed for the period from April 1, 2014 to September 30, 2017. Although the introductory language only refers to a moratorium extension for LTACH bed increases, the amendment to the MMSEA would extend both moratoriums. No exceptions will apply during this extension of the moratoriums. The original rule renewed the moratorium for the period beginning January 1, 2015; however a provision within HR4302 accelerated the moratorium period beginning on April 1, 2014.

Not later than October 1, 2015, CMS will establish a new functional status quality measure for change in mobility of ventilator patients.

As part of the fiscal year 2015 or 2016 rulemaking, CMS is to study payment rates and regulations that apply to the special category of neoplastic disease LTACHs and may adjust such payment rates.

On April 30, 2014, CMS issued a proposed rule that would update fiscal year 2015 Medicare payment policies and rates under the IPPS and the LTCH PPS. The proposed changes to payment rates under LTCH PPS would increase by 0.8% based on the proposed payment rates for fiscal year 2015. This estimated increase is attributable to several factors, including the proposed update of 2.1% (based on a market basket update of 2.7% adjusted by a multi-factor productivity adjustment of -0.4 percentage point and an additional adjustment of -0.2 percentage point in accordance with the PPACA); the one-time budget neutrality adjustment to standard

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Federal rate of approximately -1.3% under the last year of a three-year phase-in; and projected decrease in estimated high cost outlier payments as compared to fiscal year 2014. In this proposed rule, CMS stated that it was deferring proposals on new LTCH criteria and the site-neutral payment system (adopted in the Pathway for SGR Reform Act of 2013 as amended by the Protecting Access to Medicare Act of 2014) until the fiscal year 2016 LTCH PPS proposed rule.

None of the above described estimated changes to Medicare payments for home health, hospice and LTACHs for 2014 include the deficit reduction sequester cuts to Medicare that began on April 1, 2013, which reduced Medicare payments by 2% for patients whose service dates ended on or after April 1, 2013.

RESULTS OF OPERATIONS

Three months ended March 31, 2014

Consolidated financial statements

The following table summarizes our consolidated results of operations for the three months ended March 31, 2014 and 2013 (amounts in thousands, except percentages which are percentages of consolidated net service revenue, unless indicated otherwise):

	2014		2013		Increase (Decrease)	Percentage Change
Net service revenue	$ 163,681		$ 161,953		$ 1,728	1.1%
Cost of service revenue	97,334	59.5%	93,248	57.6%	4,086	4.4
Provision for bad debts	3,362	2.1%	3,917	2.4%	(555)	(14.2)
General and administrative expenses	54,612	33.4%	51,623	31.9%	2,989	5.8
Income tax expense	2,923	41.8%(1)	4,536	41.9%(1)	(1,613)	(35.6)
Noncontrolling interest	1,027		1,983		(956)	
Total non-operating income (loss)	(355)		(360)		5	
Net income attributable to LHC Group, Inc. s common stockholders	$ 4,068		$ 6,286		$ (2,218)	

(1) Percentage of income from continuing operations attributable to LHC Group, Inc. s common stockholders

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Net service revenue

The following table sets forth each of our segment s revenue growth or loss, admissions, census, episodes and patient days for the three months ended March 31, 2014 and the related change from the same period in 2013 (amounts in thousands, except admissions, census, episode data and patient days):

	Same Store(1)	De Novo(2)	Organic(3)	Organic Growth (Loss) %	Acquired(4)	Total	Total Growth (Loss) %
Home-Based Services							
Revenue	$ 122,384	$ 211	$ 122,595	(5.0)%	$ 6,085	$ 128,680	0.3%
Revenue Medicare	$ 94,813	$ 104	$ 94,917	(5.5)%	$ 5,026	$ 99,943	(0.5)%
New Admissions	29,021	91	29,112	(4.5)%	1,911	31,023	1.8%
New Medicare Admissions	19,658	52	19,710	(4.2)%	1,425	21,135	2.7%
Average Census	31,594	123	31,717	(10.8)%	1,859	33,576	(5.6)%
Average Medicare Census	23,446	34	23,480	(11.7)%	1,485	24,965	(6.2)%
Home Health Episodes	40,563	11	40,574	(5.2)%	1,861	42,435	(0.9)%
Hospice-Based Services							
Revenue	$ 14,305		$ 14,305	10.8%	$ 917	$ 15,222	17.9%
Revenue Medicare	$ 13,259		$ 13,259	10.5%	$ 896	$ 14,155	17.9%
New Admissions	1,165		1,165	(8.6)%	67	1,232	(3.4)%
New Medicare Admissions	1,002		1,002	(13.7)%	63	1,065	(8.3)%
Average Census	1,137		1,137	6.1%	86	1,223	14.2%
Average Medicare Census	1,039		1,039	6.5%	85	1,124	15.2%
Patient days	103,430		103,430	7.3%	6,613	110,043	14.2%
Facility-Based Services							
Revenue	$ 19,779		$ 19,779	(0.9%)		$ 19,779	(0.9)%
Patient days	16,462		16,462	2.1%		16,462	2.1%

(1) Same store location that has been in service with us for greater than 12 months.
(2) De Novo internally developed location that has been in service with us for 12 months or less.
(3) Organic combination of same store and de novo.
(4) Acquired purchased location that has been in service with us for 12 months or less.

Total organic home-based services revenue for the three months ended March 31, 2014 decreased 5.0% as compared to the same period in 2013, and organic Medicare revenue decreased 5.5%. During the three months ended March 31, 2014, we had 130 agency closures due to inclement weather events, which resulted in decreases in patient admission volumes. This decrease in patient admission volumes combined with the negative impact of Medicare sequestration and rebasing ultimately resulted in a decrease in revenue.

Total organic hospice-based services revenue for the three months ended March 31, 2014 increased 10.8% as compared to the same period in 2013 due to the combination of an increase in patients on census and the successful execution of same store growth strategies, all of which were then partially offset by the negative impact of Medicare sequestration.

Facility-based net service revenue decreased in the three months ended March 31, 2014 as compared to the same period in 2013 due to the negative impact of Medicare sequestration, which was then partially offset by the increase in patient day volumes.

Organic growth is generated by population growth in areas covered by mature agencies, agencies five years old or older, and by increased market share in acquired and developing agencies. Historically, acquired agencies have the highest growth in admissions and average census in the first 24 months after acquisition, and have the highest contribution to organic growth, measured as a percentage, in the second full year of operation after the acquisition.

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Cost of service revenue

The following table summarizes cost of service revenue (amounts in thousands, except percentages, which are percentages of the segment s respective net service revenue):

	Three Months Ended March 31,			
	2014		2013	
Home-based services				
Salaries, wages and benefits	$ 68,587	53.3%	$ 65,412	50.7%
Transportation	4,808	3.7	5,176	4.0
Supplies and services	3,049	2.4	2,947	2.3
Total	$ 76,444	59.4%	$ 73,535	57.0%
Hospice-based services				
Salaries, wages and benefits	$ 6,130	40.3%	$ 5,509	42.7%
Transportation	665	4.4	632	4.9
Supplies and services	2,102	13.8	1,914	14.8
Total	$ 8,897	58.5%	$ 8,055	62.4%
Facility-based services				
Salaries, wages and benefits	$ 7,890	39.9%	$ 7,280	36.5%
Transportation	66	0.3	71	0.3
Supplies and services	4,037	20.4	4,307	21.6
Total	$ 11,993	60.6%	$ 11,658	58.4%

Consolidated cost of service revenue for the three months ended March 31, 2014 was $97.3 million compared to $93.2 million for the same period in 2013, an increase of $4.1 million, or 4.4%. For home-based services and hospice-based services, the increase was primarily due to an increase in salaries, wages and benefits from agencies acquired since March 31, 2013. For facility-based services, the increase was primarily due to an increase in salaries, wages and benefits caused by the increase in skilled labor needed to service the increase in patient acuity, which was then partially offset by the decreased use of certain pharmaceutical supplies and laboratory expenses.

Provision for bad debts

Consolidated provision for bad debts for the three months ended March 31, 2014 was $3.4 million compared to $3.9 million for the same period in 2013, a decrease of $0.5 million, or 14.2%. For home-based services, provision for bad debts reported in 2013 included expense associated with certain collectability risks identified on a group of claims from certain commercial insurance payor contracts, which did not then recur in 2014. For hospice-based services, provision for bad debts decreased in 2014 due to the recognition of a Change in Ownership (CHOW) by CMS for two agencies acquired in 2013. These CHOWs allowed previously at risk patient claims to be billed and collected, thereby reducing provision for bad debts during 2014.

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General and administrative expenses

The following table summarizes general and administrative expenses (amounts in thousands, except percentages, which are percentages of the segment s respective net service revenue):

	Three Months Ended March 31,			
	2014		2013	
Home-based services				
General and administrative	$ 43,000	33.4%	$ 41,036	31.8%
Depreciation	1,544	1.2	1,386	1.1
Total	$ 44,544	34.6%	$ 42,422	32.9%
Hospice-based services				
General and administrative	$ 4,199	27.6%	$ 3,586	27.8%
Depreciation	248	1.6	164	1.3
Total	$ 4,447	29.2%	$ 3,750	29.1%
Facility-based services				
General and administrative	$ 5,288	26.7%	$ 5,171	25.9%
Depreciation	333	1.7	280	1.4
Total	$ 5,621	28.4%	$ 5,451	27.3%

Consolidated general and administrative expenses for the three months ended March 31, 2014 was $54.6 million compared to $51.6 million for the same period in 2013, an increase of $3.0 million, or 5.8%. For home-based services and hospice-based services, general and administrative expenses increased due to agencies acquired since March 31, 2013, acquisition-related costs, and Point of Care (POC) device costs, which were partially offset by reductions of staff resulting from the benefits derived from POC initiatives implemented over the past year. For facility-based services, depreciation increased due to equipment purchases.

Income tax expense

Consolidated income tax expense for the three months ended March 31, 2014 was $2.9 million compared to $4.5 million for the same period in 2013, a decrease of $1.6 million, or 35.6%. Income tax expense decreased in direct correlation to the decrease in income before income taxes and noncontrolling interest.

Noncontrolling interest

Consolidated noncontrolling interest for the three months ended March 31, 2014 was $1.0 million compared to $2.0 million for the same period in 2013, a decrease of $1.0 million, or 48.3%. The decrease was primarily related to an overall decrease in census amongst joint venture locations, which resulted in decrease in operating results of the joint ventures themselves.

LIQUIDITY AND CAPITAL RESOURCES

Liquidity

Our principal source of liquidity for operating activities is the collection of patient accounts receivable, most of which are collected from governmental and third party commercial payors. We also have the ability to obtain additional liquidity, if necessary, through our credit facility, which provides for aggregate borrowings, including outstanding letters of credit, up to $100 million.

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Our reported cash flows from operating activities are affected by various external and internal factors, including the following:

Operating Results Our net income has a significant effect on our operating cash flows. Any significant increase or decrease in our net income could have a material effect on our operating cash flows.

Timing of Acquisitions We use our operating cash flows for acquisitions. When the acquisitions occur at or near the end of a period, our cash outflows significantly increase.

Timing of Payroll Our employees are paid bi-weekly on Fridays; therefore, operating cash flows decline in reporting periods that end on a Friday.

Medical Insurance Plan Funding We are self-funded for medical insurance purposes. Any significant changes in the amount of insurance claims submitted could have a direct effect on our operating cash flows.

Medical Supplies A significant expense associated with our business is the cost of medical supplies. Any increase in the cost of medical supplies, or in the use of medical supplies by our patients, could have a material effect on our operating cash flows.

The following table summarizes changes in cash (amounts in thousands):

	Three Months Ended March 31,	
	2014	**2013**
Net cash provided by (used in):		
Operating activities	$ 6,103	$ 14,069
Investing activities	(62,679)	(20,806)
Financing activities	45,957	421
Change in cash	(10,619)	(6,316)
Cash and cash equivalents at beginning of period	14,014	9,720
Cash and cash equivalents at end of period	$ 3,395	$ 3,404

Cash provided by operating activities for the three months ended March 31, 2014 decreased as compared to the same period in 2013 due to lower net income in the period combined with other changes in working capital. Cash collections generated from accounts receivable increased due to the overall improved collection experience and the recognition of CHOWs by CMS for two agencies acquired in 2013. Additionally, salaries, wages, and benefits payable decreased due to the timing of funded payroll.

Cash used in investing activities for the three months ended March 31, 2014 increased as compared to the same period in 2013 due to the acquisition of the home health, hospice and community-based service lines of Deaconess HomeCare, LLC, a subsidiary of BioScrip, Inc.

Cash provided by financing activities for the three months ended March 31, 2014 increased as compared to the same period in 2013 due to the proceeds taken from the line of credit to fund the Deaconess HomeCare, LLC acquisition and the reduction in the amount of net repayment activity on our credit facility.

Accounts Receivable and Allowance for Uncollectible Accounts

For home-based services and hospice-based services, we calculate the allowance for uncollectible accounts as a percentage of total patient receivables. The percentage changes depending on the payor and increases as the patient receivables age. For facility-based services, we calculate the allowance for uncollectible accounts based on a claim by claim review.

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As of March 31, 2014, our allowance for uncollectible accounts, as a percentage of patient accounts receivable, was approximately 14.9%, or $14.8 million, compared to 13.9% or $14.3 million at December 31, 2013. Days sales outstanding as of March 31, 2014 and December 31, 2013 was 46 and 49 days, respectively.

The following table sets forth as of March 31, 2014, the aging of accounts receivable (based on the end of episode date) (amounts in thousands):

Payor	0-90	91-180	181-365	Over 365	Total
Medicare	$ 47,467	$ 8,407	$ 5,869	$ 1,436	$ 63,179
Medicaid	2,515	376	538	127	3,556
Other	19,310	4,819	5,302	3,123	32,554
Total	$ 69,292	$ 13,602	$ 11,709	$ 4,686	$ 99,289

The following table sets forth as of December 31, 2013, the aging of accounts receivable (based on the end of episode date) (amounts in thousands):

Payor	0-90	91-180	181-365	Over 365	Total
Medicare	$ 51,030	$ 9,858	$ 9,278	$ 653	$ 70,819
Medicaid	2,055	581	407	118	3,161
Other	15,542	5,246	5,751	2,779	29,318
Total	$ 68,627	$ 15,685	$ 15,436	$ 3,550	$ 103,298

Indebtedness

As of March 31, 2014 we had $23.3 million available, $70.0 million drawn, and $6.7 million of letters of credit outstanding under our credit facility. At December 31, 2013, we had $22.0 million drawn and $6.7 million of letters of credit outstanding under our credit facility.

Our credit agreement with Capital One, National Association provides for a maximum aggregate principal borrowing of $100 million. Our credit facility, which is scheduled to expire on August 31, 2015, is unsecured and has a letter of credit sub-limit of $15 million. A fee of 0.5% is charged for any unused amounts. A letter of credit fee equal to the applicable LIBOR margin multiplied-by the face amount of the letter of credit is charged upon the issuance and on each anniversary date while the letter of credit is outstanding. The agent s standard up-front fee and other customary administrative charges will also be due upon issuance of the letter of credit along with a renewal fee on each anniversary date of such issuance while the letter of credit is outstanding. The interest rate for the borrowings under our credit facility, at our election, shall be either at the Base Rate (as defined in the credit agreement) as a function of the prime rate or the LIBOR Rate (as defined in the credit agreement). Borrowings accruing interest under the credit facility at either the Base Rate or the LIBOR Rate are subject to the applicable margins set forth below:

Leverage Ratio

	LIBOR Margin	**Base Rate Margin**
<1.00:1.00	2.25%	1.00%
≥1.00:1.00<1.50:1.00	2.50%	1.25%
≥1.50:1.00£2.00:1.00	2.75%	1.50%

Our credit facility contains customary affirmative, negative and financial covenants. For example, without prior approval of our bank group, we are restricted in incurring additional debt, disposing of assets, making investments, allowing fundamental changes to our business or organization, and making certain payments in respect of stock or other ownership interests, such as dividends and stock repurchases, up to $50 million. Under our credit facility, we are also required to meet certain financial covenants with respect to minimum fixed charge coverage, consolidated net worth and leverage ratios.

Our credit facility also contains customary events of default. These include bankruptcy and other insolvency events, cross-defaults to other debt agreements, a change in control involving us or any subsidiary guarantor, and the failure to comply with certain covenants.

At March 31, 2014, we were in compliance with all covenants contained in the Credit Agreement governing our credit facility.

Contingencies

For a discussion of contingencies, see Note 8 of the Notes to Condensed Consolidated Financial Statements, which is incorporated herein by reference.

Off-Balance Sheet Arrangements

We do not currently have any off-balance sheet arrangements with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in these relationships.

Critical Accounting Policies

For a discussion of critical accounting policies concerning revenue recognition, see Note 2 of the Notes to Condensed Consolidated Financial Statements, which is incorporate herein by reference.

Accounts Receivable and Allowances for Uncollectible Accounts

We report accounts receivable net of estimated allowances for uncollectible accounts and adjustments. Accounts receivable are uncollateralized and primarily consist of amounts due from Medicare, other third-party payors, and patients. To provide for accounts receivable that could become uncollectible in the future, we establish an allowance for uncollectible accounts to reduce the carrying amount of such receivables to their estimated net realizable value.

The collection of outstanding receivables is our primary source of cash collections and is critical to our operating performance. Because Medicare is our primary payor, the credit risk associated with receivables from other payors is limited. We believe the credit risk associated with our Medicare accounts, which represent 63.6% and 68.6% of our patient accounts receivable as of March 31, 2014 and December 31, 2013, respectively, is limited due to (i) the historical collections from Medicare and (ii) the fact that Medicare is a U.S. government payor. We do not believe that there are any other significant concentrations of receivables from any particular payor that would subject it to any significant credit risk in the collection of accounts receivable.

The amount of the provision for bad debts is based upon our assessment of historical and expected net collections, business and economic conditions and trends in government reimbursement. Quarterly, we perform a detailed review of historical writeoffs and recoveries as well as recent collection trends. Uncollectible accounts are written off when we have exhausted collection efforts and concluded the account will not be collected.

Although our estimated reserves for uncollectible accounts are based on historical experience and the most current collection trends, this process requires significant judgment and interpretation of the observed trends and the actual

collections could differ from our estimates.

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Insurance

We retain significant exposure for our employee health insurance, workers compensation, employment practices and professional liability insurance programs. Our insurance programs require us to estimate potential payments on filed claims and/or claims incurred but not reported. Our estimates are based on information provided by the third-party plan administrators, historical claim experience, expected costs of claims incurred but not paid and expected costs associated with settling claims. Each month we review the insurance-related recoveries and liabilities to determine if any adjustments are required.

Our employee health insurance program is self funded, with stop-loss coverage on claims that exceed $0.2 million for any individually covered employee or employee family member. We are responsible for workers compensation claims up to $0.4 million per individual incident.

Malpractice, employment practices and general liability claims for incidents which may give rise to litigation have been asserted against us by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. We are aware of incidents that have occurred through March 31, 2014 that may result in the assertion of additional claims. We currently carry professional, general liability and employment practices insurance coverage (on a claims made basis) for this exposure. We also carry D&O coverage (also on a claims made basis) for potential claims against our directors and officers, including securities actions, with a deductible of $0.8 million per security claims and $0.5 million on other claims.

We estimate our liabilities related to these programs using the most current information available. As claims develop, we may need to change the recorded liabilities and change our estimates. These changes and adjustments could be material to our financial statements, results of operations and financial condition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

As of March 31, 2014, we had $3.4 million of cash. Cash in excess of requirements is deposited in highly liquid money market instruments with maturities less than 90 days. Because of the short maturities of these instruments, we would not expect our operating results or cash flows to be materially affected by the effect of a sudden change in market interest rates on our portfolio. In 2014, the FDIC will insure each depositor up to $250,000 in coverage at each separately chartered insured depository institution. At times, cash in banks is in excess of the FDIC insurance limit. The Company has not experienced any loss as a result of those deposits in excess of the FDIC insurance limit and does not expect any in the future.

Our exposure to market risk relates to changes in interest rates for borrowings under our credit facility. Our credit facility is a revolving credit facility and, as such, we borrow, repay and re-borrow amounts as needed, changing the average daily balance outstanding under our credit facility. A hypothetical 100 basis point increase in interest rates on the average daily amounts outstanding under our credit facility would have increased interest expense by less than $1,000 for the three months ended March 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Exchange Act) that are designed to ensure that information that we are required to disclose in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report.

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Based on the evaluation of our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) were effective as of March 31, 2014.

Changes in Internal Controls Over Financial Reporting

There have not been any changes in our internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Exchange Act, during the quarterly period ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a discussion of legal proceedings, see Note 8 of the Notes to Condensed Consolidated Financial Statements, which is incorporated herein by reference.

ITEM 1A. RISK FACTORS.

There have been no material changes from the information included in Part I, Item 1A. Risk Factors of the Company s 2013 Form 10-K.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

In October 2010, the Company s Board of Directors authorized a program to repurchase shares of the Company s common stock, par value $0.01 per share, from time to time, in an amount not to exceed $50.0 million (Stock Repurchase Program). The Company anticipates that it will finance any future repurchases under the Stock Repurchase Program with cash from general corporate funds, or draws under its credit facility, the terms of which allow us to purchase up to $50.0 million of the Company s common stock without obtaining approval from the bank group that holds the Company s debt. The Company may repurchase shares of its common stock in open market purchases or in privately negotiated transactions in accordance with applicable securities laws, rules and regulations. The timing and extent to which the Company repurchases its shares will depend upon market conditions and other corporate considerations. During the three months ended March 31, 2014, no shares were repurchased. The remaining dollar value of shares authorized to be purchased under the Share Repurchase Program was $22.5 million as of March 31, 2014.

ITEM 6. EXHIBITS.

2.1 Stock Purchase Agreement dated February 1, 2014, between Deaconess HomeCare, LLC and LHC Group, Inc. (previously filed as Exhibit 10.1 to the Form 8-K file February 3, 2014), as amended by that certain Amendment to Stock Purchase Agreement dated March 31, 2014, between Deaconess Homecare, LLC

	and LHC Group, Inc. (previously filed as Exhibit 2.1 to the Form 8-K filed on April 1, 2014).
3.1	Certificate of Incorporation of LHC Group, Inc. (previously filed as an Exhibit 3.1 to the Form S-1/A (File No. 333-120792) on February 14, 2005).
3.2	Bylaws of LHC Group, Inc. as amended on December 31, 2007 (previously filed as Exhibit 3.2 to the Form 10-Q on May 9, 2008).
4.1	Specimen Stock Certificate of LHC Group s Common Stock, par value $0.01 per share (previously filed as Exhibit 4.1 to the Form S-1/ A (File No. 333-120792) on February 14, 2005).

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31.1	Certification of Keith G. Myers, Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Jeffrey M. Kreger, Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of Chief Executive Officer and Chief Financial Officer of LHC Group, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Schema Document
101.CAL	XBRL Calculation Linkbase Document
101.DEF	XBRL Definition Linkbase Document
101.LAB	XBRL Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

* This exhibit is furnished to the SEC as an accompanying document and is not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that Section, and the document will not be deemed incorporated by reference into any filing under the Securities Act of 1933.

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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.

	LHC GROUP, INC.
Date: May 8, 2014	/s/ Jeffrey M. Kreger **Jeffrey M. Kreger** **Executive Vice President and Chief Financial Officer** **(Principal financial officer)**

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