

FERRIS, BAKER WATTS, INCORPORATED

Equity Research – Specialty Finance

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Nicholas Financial, Inc. (NICK) Raising Target—Buy

<u>Price (04/27/06)</u>	<u>Target</u>	<u>52-Wk Range</u>	<u>Market Value</u>	<u>Dividend</u>	<u>Yield</u>
\$13.04	\$14.75	\$13.27–\$9.74	\$129.1 mil.	\$0.00	0.0%

Shares Out:	9.9 mil.	ROAE:	19.0%
Float:	7.8 mil.	Est. Book Value (03/31/06)	\$5.81
Avg. Trading Volume:	26,000	Est. EPS Growth:	15%

Earnings Per Share:

		2005 A	2006 A	2007 E	Prior Est.	2008 E	Prior Est.
June	1Q	\$0.18	\$0.23	\$0.26		NE	
Sept.	2Q	\$0.18	\$0.24	\$0.28		NE	
Dec.	3Q	\$0.21	\$0.26	\$0.31		NE	
Mar.	4Q	<u>\$0.23</u>	<u>\$0.28</u>	<u>\$0.33</u>		<u>NE</u>	
	FY	\$0.80	\$1.01	\$1.18		\$1.35	
	P/E	16.3 x	12.9 x	11.1 x		9.7 x	

See page 4 for important disclosures and analyst certification.

- We are raising our price target on NICK shares to \$14.75 from \$13.00 to reflect the company's favorable trends in underlying loan quality and lending profitability. A comparison with the company's peers suggests a price for this stock of between \$14.33 and \$15.13 a share. Our P/E-to-growth model suggests a value of \$16.27 per NICK share.

Valuation

Nicholas has a direct, though larger, peer that operates in the same niche and originates loans through a network of local branches as well — United PanAm Financial Corp. (UPFC—\$29.67, not rated). Assuming that NICK trades at a 10% discount to its peers, NICK would be valued at close to \$14 per share (estimated 2006 calendar EPS \$1.13 x P/E of 14.1x less a mini-cap discount of 10% = value \$14.34).

Company Name	Equity Value				EV/LTM	
	PE	C06	G-04/05	P/Bk	ROE-LTM	EBITDA
United PanAm Financial Corp.	14.2		28%	307	18.77	13.0x
Branch-based Lender Median	14.1		24%	272	13.89	9.5x
Nicholas						
Calendar 2006 EPS		\$	1.13	\$	1.13	
Median PE		x	14.1x		14.1x	
Micro Cap Discount		less	10%		5%	
Implied Price		= \$	14.33	\$	15.13	

Source: FBW research, SNL Data Source, and consensus estimates (First Call)

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Our P/E-to-growth model suggests a value for NICK shares above \$16.

	NICK
LT Grwth-%	18.00
PEG -x	0.80
PE -x	14.4
EPS 06-\$	1.13
Value -\$	16.27

Source: FBW research

Favorable Trends in Underlying Loan quality

Nicholas has changed how it funds its reserve and records gross yields. On newer pools, the company is no longer writing off losses from unearned income, and as a result stated income and provision levels on these pools appear higher. This alteration has no impact on net interest income after provisions or net credit spreads (loan yields less net charge-offs), it does, on a cosmetic basis, alter the company's loan loss statistics. A closer look at net interest income (NII) after provision or at net credit spreads (loan yields less charge-offs) suggests highly favorable trends in overall lending profitability on both a quarter-over-quarter and year-over-year basis. In fiscal 2006 NII less provision increased by 29% and 25% on a full-year and quarterly basis, respectively. In FY06 net credit spreads increased on a full-year basis by 368 basis points (bps) and increased on a quarterly basis by 345bps.

	Chng			Chng		
	FY05	FY06	%	4Q05	4Q06	%
Interest Income	32,582	42,503	30%	\$9,087	\$12,130	33%
Interest Expense	3,630	4,332	19%	\$911	\$1,171	29%
Net Interest Income (NII)	28,952	38,171	32%	\$8,176	\$10,959	34%
Provisions for Losses	2,397	3,909	63%	\$591	\$1,477	150%
NII less Provision	26,555	34,262	29%	7,585	9,482	25%
	FY05	FY06	BP	4Q05	4Q06	BP
Gross Yields	25.20%	28.40%	320	26.78%	30.52%	374
Net Charge-offs	5.46%	4.98%	(48)	3.88%	4.17%	29
Net Credit Spread	19.74%	23.42%	368	22.90%	26.35%	345
Less Cost of Funds	5.70%	5.88%	18	5.68%	5.84%	16
Less Overhead to Average Recievables	10.36%	11.45%	109	10.88%	11.94%	106
Net Operating Spread	3.68%	6.09%	241	6.34%	8.57%	223
Net Charge-off ratio	5.46%	4.98%	(48)	3.88%	4.17%	29
30 Day + Delinquencies	1.47%	1.61%	14			-
Charge offs to Liquidation	6.28%	5.44%	(84)	4.35%	4.25%	(10)

Source: FBW research and company reports

Most of the increase in delinquencies that occurred between fiscal 2005 and 2006 occurred in the 30 to 59-day past due bucket and generally were attributable to higher delinquencies at newer, less mature branches.

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Nicholas Financial, Inc.	1Q07	2Q07	3Q07	4Q07	FY07E	FY08E
Income Statement (\$000s)	6/30/06	9/30/06	12/31/06	3/31/07	3/31/07	3/30/08
<i>Year End March 31</i>						
Revenue						115%
Interest Income	10,800	11,637	12,089	12,419	46,945	53,951
Interest Expense	1,122	1,122	1,122	1,122	4,488	5,027
Net Interest Income	9,678	10,515	10,967	11,297	42,457	48,924
Provisions for Losses	1,200	1,400	1,400	1,500	5,500	5,775
Software Sales	42	42	42	42	168	168
Overhead	4,180	4,539	4,646	4,762	18,127	20,426
Net Income Before Taxes	4,341	4,617	4,963	5,077	18,998	22,891
Tax Provision	1,670	1,670	1,670	1,670	6,680	8,786
Net Income	2,671	2,947	3,293	3,407	12,318	14,106
Minority Interest Expense	0	0	0	0	0	0
Other After-Tax Adjustments	0	0	0	0	0	0
Net Income before Extra	2,671	2,947	3,293	3,407	12,318	14,106
Extraordinary Items	0	0	0	0	0	0
Net Income	2,671	2,947	3,293	3,407	12,318	14,106
Preferred Dividend	0	0	0	0	0	0
Net Income Available to Common	2,671	2,947	3,293	3,407	12,318	14,106
Share and Per Share Info						
Diluted EPS \$	0.26	0.28	0.31	0.33	1.18	1.35
Average Diluted Shares	10,461,620	10,461,620	10,461,620	10,461,620	10,459,809	10,459,809
Originations (auto)	\$26,935	\$31,935	\$30,703	\$31,935	\$121,509	\$145,811
Account Recv. (Avg.)	\$153,031	\$170,988	\$177,638	\$179,165	\$170,206	\$197,081
Yield (%)	28.00	27.00	27.00	27.50	27.38	27.38
Net Charge Offs (%)	4.44	5.83	5.47	4.17	4.98	4.98
Effective Tax Rate (%)	38.5	36.2	33.6	32.9	38.4	38.4
Efficiency Ratio (%)	43.0	43.0	42.2	42.0	42.7	41.8
OH to Avg Recv. (%)	10.9	10.6	10.5	10.6	10.7	10.4
ROE (%)	17.78	18.74	19.94	19.63	19.02	18.17
Equity to Assets	46.4	47.9	49.2	50.4	45.4	45.8

Source: FBW research and company reports

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Important Disclosures and Analyst Certification

Prices herein are of the close of April 27, 2006.

At the time of this report, Ferris, Baker Watts, Inc. makes a market in the shares of Nicholas Financial, Inc.

The analyst(s) who prepared this report may be compensated in part from a bonus pool that is partially funded by fees received by Ferris, Baker Watts, Inc. for providing investment banking services.

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Analyst Certification: We, Henry J. Coffey, Jr. and Matt Schultheis, hereby certify that the views expressed in this research report accurately reflect our personal views about the subject company and its underlying securities. We further certify that we have not and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this research report.

Ratings Distribution & Investment Banking Disclosure

	Ratings Distribution [^]	Investment Banking [*]
Buy-rated	60%	21%
Hold (Neutral)-rated	37%	3%
Sell-rated	2%	0%

[^] Percentage of all FBW-covered stocks assigned an equivalent Buy, Hold, or Sell rating.

^{*} Percentage of companies within FBW-rated Buy, Neutral (Hold), and Sell categories for which FBW or an associated firm provided investment banking services within the past 12 months. Data as of 3/31/06

Rating & Target History

Nicholas Financial Inc. (NICK)
27-Jun-2003 to 27-Apr-2006 (Daily)
U.S. Dollar



Key: FBW Rating - Target
FBW initiated coverage of NICK on 6/27/03.
Source: FactSet Data Systems and FBW

Additional Information Available Upon Request

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