

FIRST FINANCIAL CORP /TX/
Form 10QSB
November 13, 2002

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended September 30, 2002 Commission file number 0-5559

FIRST FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of
incorporation or organization)

74-1502313

(I.R.S. Employer Identification No.)

800 Washington Avenue, Waco, Texas

(Address of principal executive offices)

76701

(Zip Code)

Registrant's telephone number, including area code (254) 757-2424

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, No Par Value

(Class)

173,528

(Outstanding at October 31, 2002)

FORM 10-QSB

FIRST FINANCIAL CORPORATION
SEPTEMBER 30, 2002

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First Financial Corporation
 Consolidated Balance Sheet
 September 30, 2002
 (Unaudited)

| | |
|--|---------------|
| Assets | |
| ----- | |
| Cash and cash equivalents | \$ 960,759 |
| Restricted cash | 619,609 |
| Accounts receivable | 1,619,034 |
| Marketable investment securities | 58,055 |
| Restricted marketable investment securities | 593,193 |
| Note receivable | 225,000 |
| Real estate held for investment, at cost | 444,000 |
| Mortgage loans | 41,842,958 |
| Investment in and advances to affiliated companies | - |
| Property and equipment | 654,659 |
| Other assets | 1,735,003 |
| | <hr/> |
| Total Assets | \$ 48,752,270 |
| | <hr/> |
| Liabilities and Stockholders' Equity | |
| ----- | |
| Notes on line of credit | 41,222,723 |
| Note payable | 177,197 |
| Accounts Payable | 1,518,479 |
| Estimated reserve for losses under servicing agreements | 236,929 |
| Other liabilities | 1,426,826 |
| | <hr/> |
| Total Liabilities | 44,582,154 |
| | <hr/> |
| Minority interest | - |
| | <hr/> |
| Stockholders' equity: | |
| Common stock - no par value; authorized 500,000 shares; issued 183,750 shares, of which 10,222 shares are held in treasury shares | 1,000 |
| Additional paid-in capital | 518,702 |
| Retained earnings | 3,667,373 |
| Accumulated other comprehensive income: | |

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| | |
|---|---------------|
| Unrealized gain (loss) on marketable securities, net of tax | 18,350 |
| | <hr/> |
| | 4,205,425 |
| Less:Treasury stock - at cost | (35,309) |
| | <hr/> |
| Total Stockholders' Equity | 4,170,116 |
| | <hr/> |
| Total Liabilities and Stockholders' Equity | \$ 48,752,270 |
| | <hr/> |

See accompanying notes to consolidated financial statements.

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First Financial Corporation
 Consolidated Statements of Income
 Three months and Nine months ended September 30, 2002 and 2001
 (Unaudited)

| | Three months ended September 30, | | Nine months ended September 30, | |
|--|-------------------------------------|------------------|------------------------------------|------------------|
| | 2002 | 2001 | 2002 | 2001 |
| Revenues: | | | | |
| Loan administration | \$ 2,418,155 | \$ 1,863,967 | \$ 5,304,859 | \$ 6,379,531 |
| Interest income | 713,206 | 392,647 | 1,590,831 | 1,447,001 |
| Other income | 955,734 | 520,541 | 1,562,087 | 1,011,478 |
| Total Revenues | 4,087,095 | 2,777,155 | 8,457,777 | 8,838,010 |
| Expenses: | | | | |
| Salaries and related expenses | 1,673,354 | 1,464,362 | 4,392,897 | 4,601,443 |
| Interest expense | 498,946 | 297,070 | 1,027,707 | 1,236,440 |
| Provision for losses under servicing agreements | - | - | - | - |
| Other operating expenses | 1,137,118 | 882,158 | 3,032,162 | 2,785,112 |
| Total Expenses | 3,309,418 | 2,643,590 | 8,452,766 | 8,622,995 |
| Income before income taxes, minority interest, equity in earnings (loss) of affiliates | 777,677 | 133,565 | 5,011 | 215,015 |
| Federal income taxes | - | 188 | 18 | 188 |
| Income before minority interest | 777,677 | 133,377 | 4,993 | 214,827 |
| Minority interest in net loss (income) | (49,942) | (32,615) | 370,049 | (97,512) |
| Income before equity in earnings (loss) of affiliates | 727,735 | 100,762 | 375,042 | 117,315 |
| Equity in earnings (loss) of affiliates | - | (32,984) | (206) | (25,929) |
| Net income (loss) | 727,735 | 67,778 | 374,836 | 91,386 |
| Other comprehensive income: | | | | |
| Unrealized holding gains (losses) | 53,007 | (65,896) | 16,315 | (25,248) |

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| | | | | | | | | |
|-----------------------------|----|---------|----|--------|----|---------|----|--------|
| Comprehensive income (loss) | \$ | 780,742 | \$ | 1,882 | \$ | 391,151 | \$ | 66,138 |
| Income Per Common Share | | \$4.50 | | \$0.01 | | \$2.25 | | \$0.38 |

See accompanying notes to consolidated financial statements.

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First Financial Corporation
Consolidated Statement of Cash Flows

| | (Unaudited) | |
|--|---------------------------------|---------------|
| | Nine Months Ended September 30, | |
| | 2002 | 2001 |
| | ----- | ----- |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 374,837 | \$ 66,138 |
| Adjustments to reconcile net income(loss) to net cash used by operating activities: | | |
| Depreciation | 39,292 | 177,856 |
| Provision for losses under servicing agreements | - | - |
| Equity in (income) loss of affiliates | 206 | 25,929 |
| Realized (gains) losses on marketable investment securities | 45,569 | (1,181) |
| Net (increase) decrease in accounts receivable | 102,087 | 34,265 |
| Net (increase) decrease in other assets | (593,619) | 197,002 |
| Net increase (decrease) in accounts payable | 588,711 | (203,456) |
| Net increase (decrease) in other liabilities | 774,992 | (128,900) |
| Increase (decrease) in minority interest | (1,571,344) | 97,484 |
| (Increase) decrease in restricted cash used in operating activities - net | 344,044 | (324,598) |
| Mortgage loans funded | (472,792,185) | (419,913,255) |
| Mortgage loans sold | 465,879,155 | 413,898,121 |
| Increase in mortgage loans participations sold | 9,998,521 | - |
| Other | (21,098) | 59,291 |
| | <hr/> | <hr/> |
| Net cash provided (used) for operating activities | 3,169,168 | (6,015,304) |
| | <hr/> | <hr/> |
| Cash flows from investing activities: | | |
| Proceeds from sale of marketable investment securities | 207,415 | 10,924 |
| Purchases of marketable investment securities | (19,521) | (33,097) |
| Purchases of restricted marketable investment securities | (593,193) | - |
| Unrealized holding gain (loss) | 16,314 | - |
| Proceeds from sale of property and equipment | 767,637 | - |
| (Increase) decrease in deferred gain on sale of property & equipment | (496,168) | - |
| Purchase of property and equipment | (368,020) | (70,792) |
| Principal collections on mortgage loans | 38,285 | 64,291 |
| Amortization of discount on mortgage loans purchased | - | - |
| (Advances to) repayments from affiliates | 415,514 | - |
| | <hr/> | <hr/> |
| Net cash provided (used) for investing activities | (31,737) | (28,674) |
| | <hr/> | <hr/> |
| Cash flows from financing activities: | | |
| Net change in short-term borrowings | (3,012,552) | 6,188,026 |
| (Increase) decrease in notes receivable | (225,000) | - |

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| | | |
|--|-------------|--------------|
| Net cash used for financing activities | (3,237,552) | 6,188,026 |
| Net increase (decrease) in cash and cash equivalents | (100,120) | 144,048 |
| Cash and cash equivalents at beginning of year | 1,060,879 | 868,826 |
| Cash and cash equivalents at end of period | \$ 960,759 | \$ 1,012,874 |
| Supplemental Disclosure of Cash Flow Information | | |
| Interest Paid | \$ 978,697 | \$ 1,174,467 |

See accompanying notes to consolidated financial statements.

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FIRST FINANCIAL CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

PART I - FINANCIAL INFORMATION

1 - Basis of Presentation

The financial information included herein for First Financial Corporation, and all of its wholly owned and majority owned subsidiaries (the "Company") is unaudited; however, such unaudited information reflects all adjustments which are, in management's opinion, necessary for a fair presentation of the financial position, results of operations and statement of cash flows for the interim periods. In preparing these financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the balance sheet and revenue and expense for the period. Actual results could differ significantly from those estimates.

As more fully discussed in Form 8-K dated November 14, 2002, effective July 31, 2002, the Company acquired all of the outstanding common stock of First Preference Mortgage Corp. ("FPMC") so that the Company directly owns 100% of the capital stock of FPMC. FPMC was a third-tier subsidiary of Key Group, Ltd. ("Key Group"), a Texas Limited Partnership, which the Company owned an approximately 53% interest. The Company's consolidated statements of income include the revenue and expense of Key Group for the period January 1, 2002 to July 31, 2002 and the revenue and expense of FPMC for the period August 1, 2002 to September 30, 2002. The minority interest in net loss (income) represents the ownership of other entities in the net loss (income) of Key Group.

The results of operations and changes in cash flow for the nine-month period ended September 30, 2002 are not necessarily indicative of the results to be expected for the full year.

Certain reclassifications were made to prior periods to ensure comparability with the current period.

2 - Earnings Per Share

Earnings per common share were computed by dividing net income by the weighted average number of shares outstanding.

3 - Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes related primarily to differences between the basis of the loan loss reserve for financial and income tax reporting. The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses that are available to offset future taxable income and tax

credits that are available to offset future federal income taxes. The Company has approximately \$6,000,000 in available net operating loss carryforward benefits for financial statement purposes to offset future income, if any. A valuation allowance has been provided for all tax benefits.

4 - Contingencies

Substantially all of the conventional pools of manufactured home loans serviced by the Company, approximately \$347,000 at September 30, 2002, were sold to investors with recourse. The recourse provisions typically require the Company to repurchase delinquent loans at the unpaid balances plus accrued interest, or replace delinquent loans with another loan which is current. Further, several of the agreements require the Company to establish and maintain cash reserve accounts. Deposits are periodically made to the accounts equal to a specified percent of the outstanding loans. The accounts may be used to cover deficiencies from foreclosure and liquidation of delinquent pooled mortgage loans. Such cash reserve accounts totaled \$10,495 and are included in restricted cash at September 30, 2002.

Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations

The Company had net income of \$374,836 for the nine months ended September 30, 2002 compared to net income of \$91,386 for the same period in 2001. Loan administration revenues were \$5,304,859 for the first nine months of 2002 compared to \$6,379,531 for the same period of 2001. The decrease in loan administration revenues is the result of decreased loan origination fees from the Company's retail branch mortgage loan operations. During the nine months ended September 30, 2002, First Preference Mortgage Corp. ("FPMC"), funded approximately \$63.6 million in retail residential mortgage loans and approximately \$409.2 million in wholesale loans compared to approximately \$108.0 million and \$311.9 million during the same period in 2001, respectively. Revenue generated by retail loans is approximately 450% of the revenue received from wholesale loans. In addition, during the nine months ended September 30, 2002, the revenues from the sale of the mortgage loans to governmental and private investors decreased significantly due to the unstable market conditions that prevailed during the period.

For the seven months ended July 31, 2002, Key Group had a net loss of (\$786,352) compared to net income of \$207,190 for the nine months ended September 30, 2001. This significant change by Key Group is primarily due to the decrease in retail residential mortgage loan originations and reduced revenues from the sale of the mortgage loans as discussed above. The Company's share of the net income (loss) of Key Group was (\$416,303) for the seven months ended July 31, 2002 and \$109,678 for the nine months ended September 30, 2001. The minority interest in the net loss of Key Group amounted to \$370,049 for the seven months ended July 31, 2002 compared to a minority interest in the net income of (\$97,512) for the nine months ended September 30, 2001. The minority interest represents the ownership of other entities in the Key Group net income or net loss.

For the two months ended September 30, 2002, FPMC had net income of \$744,522. Approximately \$636,000 of the net income is attributable to the recoupment of an asset valuation reserve that was required to be recorded by FPMC in connection with its acquisition by the Company as discussed above.

Interest income for the nine months ended September 30, 2002 amounted to \$1,590,831 compared to \$1,447,001 for the same period in 2001. This increase is primarily due to the increase in new residential mortgage loans originated during the first nine months of 2002 as compared to 2001 as discussed above. FPMC earns interest from the date the mortgage loan is closed until the date the mortgage loan is sold to investors.

Salaries and related expenses decreased to \$4,392,897 for the nine months ended September 30, 2002, compared to \$4,601,443 for the same period in 2001. This decrease is primarily due to the reduction in the amount of commission expense resulting from decreased retail residential mortgage loan originations as discussed above.

For the nine months ended September 30, 2002, interest expense amounted to \$1,027,707 compared to \$1,236,440 for the same period in 2001. The decrease in interest expense for the nine months ended September 30, 2002 is primarily due to decrease in the weighted average interest rate from 6.31% for the nine months ended September 30, 2001 to 4.40% for the same period in 2002.

During the nine months ended September 30, 2002, the provision for losses under servicing agreements was (\$0) resulting in a balance in the reserve for losses under servicing agreements of \$236,929 at September 30, 2002. For the nine months ended September 30, 2001, the Company had a negative provision for losses under servicing agreements of (\$0) which resulted in a balance in the reserve for losses under servicing agreements of \$236,929 at September 30, 2001. As previously discussed, under the terms of certain of its servicing agreements, the Company is at risk for any credit losses and costs of foreclosure, net of credit insurance proceeds, if any, sustained on default of the borrower. The Company has analyzed its servicing portfolio characteristics, including servicing portfolio balance, loss experience, maturity and aging of the loans and the credit insurance coverage on the loans. Based on this analysis, it is the Company's belief that its reserve for losses under servicing agreements is adequate for potential losses attributable to the servicing agreements.

Other income for the nine months ended September 30, 2002 amounted to \$1,562,087 compared to \$1,011,478 for the same period in 2001. In the second quarter of 2001, the Company evaluated its billings for consulting fees and increased the fees to reflect the current cost of providing these services. In addition, FPMC recognized approximately \$636,000 in other income as discussed above.

The consolidated statements of income for the nine months ended September 30, 2002 reflect equity in the net loss of affiliates of (\$206) compared to a net loss of \$25,248 for the same period in 2001.

Other comprehensive income consists of unrealized holding gains (losses) on marketable investment securities net of income taxes. For the nine months ended September 30, 2002, unrealized holding gains amounted to \$16,315 compared to unrealized holding losses of (\$25,248) for the nine months ended September 30, 2001.

Financial Condition

At September 30, 2002, the Company's total assets were \$48,752,270 compared to \$28,219,264 at September 30, 2001. Included in the Company's total assets at September 30, 2002 are the assets of FPMC which amounted to \$47,080,637. At September 30, 2001 the Company's assets included the assets of Key Group which amounted to \$25,220,754. The FPMC assets at September 30, 2002 consisted primarily of cash and cash equivalents of \$673,059, accounts and notes receivable of \$1,277,937, mortgage loans of \$41,777,247, property and equipment of \$444,191, real estate of \$444,000 and prepaid expenses and other assets of \$1,464,203. The minority interest in the net assets of Key Group at September 30, 2001 amounted to \$1,421,991.

On consolidated basis, cash and cash equivalents (including restricted cash) were \$1,580,368 at September 30, 2002. Included therein was cash and cash equivalents of FPMC of \$673,059 and Apex Lloyds Insurance Company of \$869,151. The cash flow of FPMC is only available to the Company as allowed under the terms of FPMC's mortgage warehouse line of credit agreement. The cash flow of Apex Lloyds Insurance Company is only available to the Company as allowed by state insurance regulations.

As more fully discussed in the Annual Report Form 10-KSB for the year ended December 31, 2001, FPMC has a mortgage warehouse line of credit with a financial institution totaling \$45,000,000 which expired March 31, 2002. This agreement was extended until October 31, 2002 and was subsequently extended to April 30, 2003. This agreement includes certain financial covenants including requirements to maintain FPMC stockholders' equity above \$3,500,000 and adjusted-tangible-net worth above \$3,200,000. Also, FPMC's total liabilities to adjusted tangible net worth may never exceed 15 to 1. In addition, FPMC has a loan participation agreement with another financial institution amounting to \$17,000,000. Under this agreement, the financial institution has the option to purchase an undivided interest in the residential mortgage loans originated by FPMC. When the subject mortgage loan is sold in the secondary market, the financial institution recoups its investment plus a specified yield on its investment.

Item 3. Controls and Procedures

Within the 90 days prior to the filing of this report, the Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures. The evaluation was carried out under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer. Based on and as of the date of the evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting them to material information relating to the Company, including its consolidated subsidiaries, required to be included in reports the Company files with or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's internal controls subsequent to the date of the evaluation.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in routine litigation incidental to its business, both as a plaintiff and a defendant. Management of the Company, after consulting with legal counsel, feels that liability resulting from the litigation, if any, will not have a material effect on this financial position of the Company.

Item 5. Other Information

This report on Form 10-Q is accompanied by a statement of the Chief Executive Officer and the Chief Financial Officer of the registrant making certain certifications as to the contents hereof, as required by Section 906 of the Sarbanes-Oxley Act of 2002.

Item 6. Exhibits and Reports on Form 8-K

A Form 8-K with a report date of May 24, 2002, was filed on August 20, 2002, pertaining to the resolution of disputes within the Mann family.

A Form 8-K with a report date of August 14, 2002, was filed on August 14, 2002, containing Certification of Principal Executive Officer and Principal Financial Officer of the contents of Form 10-Q for period ending June 30, 2002, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

First Financial Corporation

Date November 14, 2002

/s/ David W. Mann

David W. Mann
President
Duly Authorized Officer and
Principal Financial Officer

Date November 14, 2002

/s/ Robert L. Harris

Robert L. Harris
Vice President and
Principal Accounting Officer

Annual and Quarterly Certifications

Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, David W. Mann, certify that:

1. I have reviewed this quarterly report on Form 10-Q of First Financial Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 14, 2002

/s/ David W. Mann

David W. Mann

Chief Executive Officer and Chief Financial Officer