

ENTRUST FINANCIAL SERVICES INC
Form 10QSB
August 14, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

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

For the quarterly period ended June 30, 2003

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

Commission File No. 0-23965

ENTRUST FINANCIAL SERVICES, INC.
(Exact name of small business issuer as specified in its charter)

COLORADO
(State or other jurisdiction of
incorporation or organization)

84-1374481
(I.R.S. Employer Identification No.)

6795 E. Tennessee Ave.
5th Floor
Denver, Colorado 80224
(Address of principal executive offices)

Issuer's telephone number: (303) 322-6999

Check whether the issuer (1) filed all reports required to be filed by section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was Required to file such reports) and (2) has been subject to such filing requirements for the past 90 Days.

Yes No

State the number of shares outstanding of each of the issuer's common equity as of the last practicable date:

<u>Class</u>	<u>Outstanding at June 30, 2003</u>
Common Stock, No Par Value, net of Treasury Stock	2,546,795

Transitional Small Business Disclosure Format (check one):

Yes No

ENTRUST FINANCIAL SERVICES, INC.
FORM 10-QSB
TABLE OF CONTENTS

	PAGE NO.
PART I. FINANCIAL INFORMATION	
Item 1. Condensaed Consolidated Financial Statements	
Balance Sheets as of June 30, 2003 and June 30, 2002	3
Statements of Operations for the three and six months ended June 30, 2003 and 2002	4
Statements of Cash Flows for the six months ended June 30, 2003 and 2002	5
Notes to the Unaudited Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	14
Item 3. Controls and Procedures	18
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	19
Item 2. Changes in Securities and Use of Proceeds	19
Item 3. Defaults Upon Senior Securities	19
Item 4. Submission of Matters to a Vote of Security Holders	19
Item 5. Other Information	19
Item 6. Exhibits and Reports on Form 8-K	20
Item 6a. Exhibit List	20
FORM 10-QSB SIGNATURE PAGE	21
Exhibit 18 Letter on change in Accounting Principles	23
Exhibit 31.1 Certification of CEO pursuant to Sec. 302	24
Exhibit 31.2 Certification of CEO pursuant to Sec. 302	25
Exhibit 32.1 Certification of CEO pursuant to Sec. 906	26
Exhibit 32.2 Certification of CEO pursuant to Sec. 906	27

ENTRUST FINANCIAL SERVICES, INC.
Balance Sheet

	June 30, 2003 (unaudited)	December 31, 2002
ASSETS		
Cash	\$ 1,463,971	\$ 2,459,425
Loans held for sale	28,675,212	26,600,422
Accounts Receivable	95,674	863,793
Notes Receivable	500,000	500,000
Prepaid expenses and other assets	811,463	1,049,533
Intangible Assets, net	1,425,000	1,470,000
Computer, equipment furniture, net	146,117	104,677
Total assets	\$ 33,117,437	\$ 33,047,850
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Warehouse lines of credit	\$ 28,079,575	\$ 26,431,314
Convertible Promissory Note	2,000,000	2,000,000
Notes & Debenture payable	--	406,711
Loan Reserve	1,011,851	105,690
Accrued expenses and other liabilities	783,120	474,777
Total liabilities	31,874,546	29,418,492
Stockholders equity		
Preferred stock, \$.0000001 Par Value, 5,000,000 shares authorized, none issued	--	--
Common stock, \$.0000001 Par Value, 50,000,000 shares authorized, 2,546,795 shares issued at June 30, 2003 and 2,520,385 at December 31, 2002	1	1
Additional Paid-In Capital	7,579,504	7,550,504
Accumulated Deficit	(6,336,612)	(3,840,097)
Deferred Compensation	--	(81,050)
Total stockholders equity	1,242,891	3,629,358
Total liabilities and stockholders equity	\$ 33,117,437	\$ 33,047,850

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.
Statements of Operations
(Unaudited)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002	Three Months Ended June 30, 2003	Three Months Ended June 30, 2002
Revenues				
Loan Origination Fees	\$ 3,030,894	\$2,705,432	\$ 1,714,307	\$1,420,901
Premium Income	2,519,507	2,460,012	1,634,468	1,263,074
Interest income	875,523	712,108	438,762	337,934
Miscellaneous income	7,203	468	776	387
Total revenues	6,433,127	5,878,020	3,788,313	3,022,296
Expenses				
Loan Origination Costs	6,309,705	3,761,694	4,170,566	1,928,546
Interest expense	1,068,584	514,323	716,902	268,998
General & Administrative	1,197,064	1,176,717	642,754	578,194
Total expenses	8,575,353	5,452,734	5,530,222	2,775,738
Cumulative effect of change in accounting principle, net of tax	354,289	--	354,289	--
Net income (loss)	\$(2,496,515)	\$ 425,286	\$(2,096,198)	\$ 246,558
Basic earnings per common share before cumulative effect of change in accounting principle	\$ (0.84)	\$ 0.19	\$ (0.69)	\$ 0.11
Per share cumulative effect of a change in accounting principle	\$ (0.14)	--	\$ (0.14)	--
Basic earnings per share	\$ (0.98)	\$ 0.19	\$ (0.83)	\$ 0.11
Diluted earnings per share	\$ (0.98)	\$ 0.18	\$ (0.83)	\$ 0.10

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.
Statements of Cash Flow
(Unaudited)

	Six Months Ended June 30, 2003	Six Months Ended June 30, 2002
Cash flows from operating activities		
Net income (loss)	\$(2,496,515)	\$ 425,286
Adjustments to reconcile net income (loss) to net cash used in operating activities		
Depreciation	64,141	46,297
Interest Expense	327,288	--
Amortization of Intangible Assets	45,000	45,000
Stock Issued for Services	29,000	33,073
Compensation expense related to options	81,050	77,000
Changes in Assets & Liabilities:		
(Increase) Notes Receivable	--	(230,840)
(Increase) Decrease Accounts Receivable	768,119	(40,488)
(Increase) Decrease loans held for sale	(2,074,790)	1,575,548
Decrease Prepaid Expense and other assets	238,070	64,568
Increase Loan Repurchase	--	616,488
Increase Loan Reserve	906,161	29,680
(Decrease)Accrued Expense and other liabilities	(18,947)	(47,608)
	<hr/>	<hr/>
Net cash (used in) from operating activities	(2,131,423)	2,594,004
Cash flows from investing activities		
Retirement of Equipment	8,615	--
Purchase of Capital Equipment	(114,196)	(276,087)
	<hr/>	<hr/>
Net cash used in investing activities	(105,581)	(276,087)
Cash flows from financing activities		
Change in warehouse lines of credit, net	1,648,261	(2,477,550)
Decrease debenture Payable	(162,100)	--
(Decrease) Increase notes payable	(244,611)	81,930
	<hr/>	<hr/>
Net cash (used in) from financing activities	1,241,550	(2,395,620)
	<hr/>	<hr/>
Decrease in cash and cash equivalents	(995,454)	(77,703)
Cash & cash equivalents at beginning of period	2,459,425	858,848
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 1,463,971	\$ 781,145
	<hr/>	<hr/>

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

NOTE 1 - BASIS OF PRESENTATION

Entrust Financial Services, Inc. (The Company) was incorporated on November 8, 1996, under the laws of the State of Colorado as Centennial Banc Share Corporation. The name of the Company was changed to Entrust Financial Services, Inc. as of April 6, 2001. The Company was formed for the purpose of developing and maintaining the business associated with mortgage banking.

On April 30, 1999 the Company purchased 100% of Entrust Mortgage, Inc., a Colorado corporation, which is a wholly owned subsidiary of the Company and is included in the consolidated financial statements.

The Company, through its subsidiary, Entrust Mortgage, Inc. is engaged in mortgage banking activities in 38 states. The Company's mortgage banking business is principally focused on wholesale and retail residential mortgage origination activities. The Company primarily originates non-conforming mortgage loans, which are loans that do not conform to FNMA, FHLMC, FHA and VA requirements. The principal deviation from such standards relate to the lower documentation standards where there is a lower loan-to-value ratio, although some do not conform because of the size of the mortgage loan. The Company's underwriting guidelines are based upon the underwriting standards established by investors to whom such loans are sold.

Wholesale loan origination involves the funding by the Company of loans submitted by non-affiliated mortgage brokers. The Company has active contractual relationships with over 600 brokers firms and supports this clientele with traditional telemarketing and a web-based, proprietary automated underwriting system that supports the loan application process 24 hours a day, 7 days a week. In addition, the Company has a regional sales force in Florida, California, Nevada and Colorado supporting the wholesale division. The Company realizes revenue from the sale of such loans to investors for a price greater than the amount paid to the mortgage broker.

Retail loan origination involves the direct solicitation of realtors, builders and prospective borrowers for the origination of mortgage loans. The Company derives revenues from the loan origination fees and the loan premium fee that is received from the purchaser of the loan. Generally, the revenue is shared on a negotiated basis with loan officers and others who procure the loan and assist in the loan origination process. The financial benefits to the Company of the retail division is both as a source of loans for the wholesale division and as a source of loan fees to improve total profits.

Company's management monitors the revenue streams of the various products and services. Operations are managed and financial performance is evaluated on a company-wide basis. Accordingly, all of the Company's mortgage banking operation is considered by management to be aggregated in one reportable operating segment.

6

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-QSB and Regulation S-B. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements and should be read in conjunction with the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002. In the opinion of management, all adjustments considered necessary for a fair presentation of the results of operations have been included. Operating results for the three and six-month periods ended June 30, 2003 are not necessarily indicative of the results that might be expected for the 12 months ending December 31, 2003.

Use of Estimates: Accounting principles generally accepted in the United States of America require management to make estimates and assumptions in preparing financial statements that affect the amounts reported and disclosed. These estimates and assumptions may change

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

in the future, and future results could differ from these estimates. Areas involving the use of management's estimates and assumptions, which are susceptible to change in the near term, include valuation of loans held for sale and loan loss reserves.

Loan Loss Reserve: The Company's loan loss reserve can fluctuate from time to time based on management's most current estimate of risk exposure, using past experience and the most available economic circumstances. For 2003, management increased the loan loss reserve to 1/2% of 1% for wholesale loan fundings and provided an additional amount based on the loan default experience. The effect of the change in estimate was a one-time non-cash reduction to the Company's earnings of \$1.4 million or approximately \$0.55 per share, which is included in operations for the period ended June 30, 2003.

Revenue Recognition: The Company originates all of their mortgage loans with the intent to sell the mortgage loans, without retaining any interest in them into the secondary market. The Company's earnings come from fees charged at closing, margins earned by selling loans for a premium and interest paid to the Company on a loan while the Company holds the loan for sale. Loan Origination fees and the direct Loan Origination costs are deferred until the related loan is sold. Margins earned by selling loan are recognized when the purchaser has taken title and assume the risks and rewards of ownership. Income on all loans is recognized on the interest method. Accrual of interest income is suspended at the time at which collection of an account becomes doubtful.

Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements (SAB 101), which among other guidance clarified, the Staff's view on various revenue recognition and reporting matters. As a result, effective April 1, 2003, the Company adopted a change in its method of accounting for Loan Origination Fees and Costs. Under the new accounting method, the Loan Origination fees and the direct Loan Origination costs are deferred until the related loan is sold for a premium to a secondary investor. This method of recording revenue is more preferable and consistent with Financial Accounting Standards Board No. 91.

The implementation of the change has been accounted for as a change in accounting principle and applies cumulatively as if the change occurred at April 1, 2003. The effect of the change was a one-time non-cash reduction to the Company's earnings of \$354,289 or approximately \$0.14 per share, which is included in operations for the period ended June 30, 2003.

7

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

Loans Held for Sale: Balances include deferred origination fees and costs and are stated at the lower of cost or market value in the aggregate. The market value of mortgage loans held for sale is based on market prices and yields at period end in normal market outlets used by the Company.

Impact of Interest Rate Fluctuations: Interest rate fluctuations generally have a direct impact on a mortgage banking institution's financial performance. Significant increases in interest rates may make it more difficult for potential borrowers to purchase residential property and to qualify for mortgage loans as well as potentially reduce the number of borrowers who are seeking to refinance their current loan. As a result, the volume and related income from loan originations may be reduced.

Significant decreases in interest rates may enable more potential borrowers to purchase residential property and to qualify for a mortgage loan as well as potentially increase the number of borrowers who are seeking to refinance their current loan. As a result, the volume and related income from loan originations may increase. However, significant decreases in interest rates may result in higher anticipated loan prepayment activity.

Reclassifications: Certain prior period amounts have been reclassified to conform to the current presentation. There was no impact to net income (loss) in any period.

NOTE 2 - CONVERTIBLE PROMISSORY NOTE

The Company has a Convertible Promissory Note (Note) maturing on March 27, 2005. The interest is payable at 12% per annum, payable monthly, in arrears, and there is a 33% bonus interest payable only upon maturity or prepayment of the Note. However, upon maturity or

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

prepayment of the Note, the Lender has the option of either receiving the additional bonus interest or foregoing the additional bonus interest and converting the Note into common stock at a conversion price of \$3.00 per share, subject to price adjustments in certain defined circumstances. The Note is secured by all the assets (e.g. accounts, contracts, intangible assets, furniture & fixtures) of Entrust Mortgage, Inc. In addition, the Company entered into a Pledge Agreement, where by all the shares of the common stock of Entrust Mortgage, Inc. are held by the lender to ensure timely payment and performance of the obligation.

The Note contains financial covenants. Beginning in July 2003, the Company was in default under certain financial performance covenants because of its second quarter loss. As a consequence, the Note has been classified as debt due within one year. In accordance with the Note, the Company deposited \$100,000 into a sinking fund on August 1, 2003 and will be required to make a \$100,000 deposit on a monthly basis until the default is cured. The lender also informed the Company that there was a default in certain unspecified representation covenants relating to the Note. The Company disagrees that there has been a default in any representation covenants.

8

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

Finally, the lender has informed the Company that it is not declaring the Note due and payable but is reserving its future remedies. The Company believes that should the note be called the Company has adequate resources to satisfy this obligation. However, in accordance with the Pledge Agreement, the lender can exercise its future remedies and take control of Entrust Mortgage, Inc., the only substantial asset of the Company, at any time until all defaults are cured. The Company is currently having discussions with the lender to resolve all outstanding issues. However the Company does not know at this time what the outcome of those discussions will be.

NOTE 3 - WAREHOUSE LINES OF CREDIT

The Company funds mortgage loan originations using various warehouse lines of credit, which are secured by the mortgage loans funded by the lines. Amounts outstanding under the various credit facilities consist of the following:

	June 30, 2003	December 31, 2002
\$27.35 million mortgage warehouse credit facility at a commercial bank; interest at the 30-day LIBOR plus 225 to 375 basis points; expires May 31, 2004; interest rate was 3.62% at June 30, 2003	\$27,064,525	\$25,496,014
\$3 million mortgage warehouse credit facility at a commercial bank; interest at the 30-day LIBOR plus 375 basis points; expires July 2, 2004; interest rate was 4.93% at June 30, 2003	\$ 1,015,050	\$ 935,300
	<u>\$28,079,575</u>	<u>\$26,431,314</u>

9

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

NOTE 4 - EARNINGS PER SHARE

The following summarizes the computation of basic and diluted earnings per share:

	Three Months Ended	
	June 30,	
	2003	2002
Basic (loss) earnings per share		
Net (loss)income for common stockholders	\$(2,096,198)	\$ 246,558
Weighted average shares outstanding	2,533,590	2,283,622
Basic (loss) earnings per share	\$ (.83)	\$.11
Diluted (loss) earnings per share		
Net (loss)income for common stockholders	\$(2,096,198)	\$ 246,558
Weighted average shares outstanding	2,533,590	2,283,622
Diluted effect of assumed exercise of stock options	--	82,500
Diluted average shares outstanding	2,533,590	2,366,122
Basic (loss) earnings per share	\$ (.83)	\$.10
	Six Months Ended	
	June 30,	
	2003	2002
Basic (loss) earnings per share		
Net (loss)income for common stockholders	\$ (2,496,515)	\$ 425,286
Weighted average shares outstanding	2,533,590	2,283,622
Basic (loss) earnings per share	\$ (.98)	\$.19
Diluted (loss) earnings per share		
Net (loss)income for common stockholders	\$ (2,496,515)	\$ 425,286
Weighted average shares outstanding	2,533,590	2,283,622
Diluted effect of assumed exercise of		

	Three Months Ended June 30,	
stock options	--	82,500
	<hr/>	<hr/>
Diluted average shares outstanding	2,533,590	2,366,122
	<hr/>	<hr/>
	<hr/>	<hr/>
Diluted (loss) earnings per share	\$ (.98)	\$.18
	<hr/>	<hr/>
	<hr/>	<hr/>

10

ENTRUST FINANCIAL SERVICES, INC.

Notes to Financial Statements

June 30, 2003

(Unaudited)

For the three and six months ended June 30, 2003, options to purchase 130,000 of common stock at an average price of \$1.60 and warrants to purchase 758,567 shares of common stock at an average price of \$1.29 per share were outstanding but were not included in the calculation of diluted earnings per share because the exercise price was greater than the average market price of the common stock and was, therefore, anti-dilutive.

NOTE 5 - COMMITMENTS:

On July 5, 2002 the Company's Chairman resigned as the CEO and Chairman of the Board. Beginning in July 2002 and continuing for a period of forty-eight months, he shall be entitled to an amount equivalent to 15 basis points on the first \$12,500,000 in monthly funding and 5 basis points on the remaining monthly funding on wholesale and retail loans funded by the Company or the Company's lenders on behalf of the Company. Payments are made monthly and the Company is current on its obligation.

On July 23, 2002 the Company's Chairman of the Advisory Board resigned. The settlement agreement outlines options for a total of 70,000 shares of common stock to be issued at fair market value, provided, however that a maximum of 10,000 shares may be exercised per quarter starting September 30, 2002 and ending March 31, 2004. Such options are fully vested as of the exercise date. In addition, he will be paid \$21,500 per quarter as additional compensation bonus, which he agrees and covenants to apply all such payments solely to the exercise of his stock options. Such bonus is non-cancelable until it expires March 31, 2004.

NOTE 6 - NEW ACCOUNTING PRONOUNCEMENTS

In November 2002 the FASB issued Interpretation (FIN) No. 45, Guarantor