

ENTRUST FINANCIAL SERVICES INC
Form 10QSB
November 08, 2004

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 ended September 30, 2004

TRANSITION UNDER 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 in its charter)

Colorado
(State of incorporation)

84-1374481
(I.R.S. Employer File Number)

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

(303) 322-6999
(Issuer's telephone number, including area code)

Securities Registered Under Section 12(b) of the Exchange Act: None

Securities Registered Under Section 12(g) of the Exchange Act:

Common Stock, \$.0000001 per share par value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 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 September 30, 2004</u>
Common Stock, \$.0000001 par value, net of Treasury Stock	2,586,795

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

Transitional Small Business Disclosure Format (check one): Yes [] No [X]

References in this document to us, we, our, or the Company refer to Entrust Financial Services, Inc. its predecessors and its subsidiaries.

FORM 10-QSB Entrust Financial Services, Inc. INDEX

	Page

PART I. FINANCIAL INFORMATION	
Item 1. Condensed Consolidated Financial Statements	
Balance Sheets as of September 30, 2004 and December 31, 2003	3
Statements of Operations for the three months ended and nine months ended September 30, 2004 and 2003	4
Statements of Cash Flows for the nine months ended September 30, 2004 and 2003	5
Notes to the Unaudited Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	11
Item 3. Controls and Procedures	14
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	15
Item 2. Changes in Securities and Use of Proceeds	15
Item 3. Defaults Upon Senior Securities	15
Item 4. Submission of Matters to a Vote of Security Holders	15
Item 5. Other Information	15
Item 6. Exhibits and Reports on Form 8-K	15
Item 6a. Exhibit List	15
Form 10-QSB Signature Page	16
Exhibit 31.1 Certification of CEO pursuant to Sec. 302	18
Exhibit 31.2 Certification of CFO pursuant to Sec. 302	19
Exhibit 32.1 Certification of CEO pursuant to Sec. 906	20
Exhibit 32.2 Certification of CFO pursuant to Sec. 906	21

PART 1 - FINANCIAL INFORMATION

ITEM 1. Financial Statements:

ENTRUST FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2004 (unaudited)	December 31, 2003
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 955,572	\$ 1,042,742
Cash, restricted	302,650	500,050
Accounts receivable	260,394	94,773
Mortgage loans held for sale	7,771,401	25,506,524
Prepaid expenses and other current assets	164,767	141,511
	9,454,783	27,285,600
Total current assets		
Property and equipment, net	418,437	398,833
OTHER ASSETS		
Intangibles, net	1,312,500	1,380,000
Deposits	282,041	389,278
	1,594,542	1,769,278
Total other assets		
TOTAL ASSETS	\$ 11,467,762	\$ 29,453,711
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
CURRENT LIABILITIES		
Warehouse lines of credit	\$ 7,172,334	\$ 24,670,295
Accounts payable	75,678	105,270
Accrued other expenses	729,662	1,247,091
Loan indemnification reserve, current portion	405,086	159,359
Convertible Promissory Note, current portion	900,000	2,000,000
Capital lease obligations, current portion	70,622	70,622
	9,353,382	28,252,637
Total current liabilities		
Convertible Promissory Note, less current portion	800,000	--
Loan indemnification reserve, less current portion	947,425	962,707
Capital lease obligations, less current portion	82,237	135,026
	11,183,044	29,350,370
Total liabilities		
STOCKHOLDERS' EQUITY		
Common stock, \$.0000001 par value, 50,000,000 shares authorized, 2,586,795 issued and outstanding for 2004 and 2,576,795 issued and outstanding for 2003	1	1
Paid-in capital	7,585,155	7,583,655
Retained earnings	(7,300,437)	(7,480,315)
	218,718	103,341
Total stockholders' equity		

	September 30, 2004 (unaudited)	December 31, 2003
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 11,467,762	\$ 29,453,711

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2004	September 30, 2003	September 30, 2004	September 30, 2003
REVENUE				
Loan origination fees and gain on sale of loans	\$ 5,513,902	\$ 3,395,941	\$ 13,948,504	\$ 8,953,544
Direct costs of loan origination	(2,882,749)	(1,579,698)	(7,020,559)	(3,967,422)
Interest income	682,218	498,878	1,501,400	1,374,401
Interest expense, warehouse and other debt	(491,598)	(317,194)	(1,055,209)	(881,611)
Total revenue	2,821,773	1,997,927	7,374,136	5,478,912
EXPENSES				
Salaries, commissions, and benefits	1,693,762	1,223,012	4,272,293	3,505,856
Occupancy, equipment and communication	174,245	114,314	511,155	333,842
General and administrative	262,107	357,715	679,801	1,009,975
Provision for loan losses	438,284	299,270	1,181,119	2,154,542
Interest Expense, convertible promissory note	72,268	251,157	389,666	754,643
Depreciation expense	29,908	35,652	92,725	99,792
Amortization expense	22,500	22,500	67,500	67,500
Total expenses	2,693,074	2,303,620	7,194,259	7,926,150
Cumulative effect of change in accounting principle	--	--	--	354,289
INCOME (LOSS) BEFORE INCOME TAXES	128,699	(305,693)	179,877	(\$ 2,801,527)
PROVISION FOR INCOME TAXES	--	--	--	--
NET LOSS	\$ 128,699	(\$ 305,693)	\$ 179,877	(\$ 2,801,527)

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

	Three Months Ended		Nine Months Ended	
Basic Earnings per share	\$ 0.05	\$ (0.12)	\$ 0.07	\$ (1.11)
Diluted earnings per share	\$ 0.04	\$ (0.12)	\$ 0.06	\$ (1.11)
Basic Weighted Average Shares Outstanding	2,581,795	2,533,590	2,581,795	2,533,590
Diluted Weighted Average Shares Outstanding	3,011,795	2,533,590	3,011,795	2,533,590

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended Sept 30, 2004	Nine Months Ended Sept 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 179,877	\$(2,801,529)
Non-cash items-		
Depreciation and amortization	160,225	167,292
Provision for loan losses	226,445	931,604
Other	1,500	110,050
(Increase) decrease in-		
Accounts receivable	(165,621)	762,131
Mortgage loans held for sale	17,735,123	(2,196,915)
Prepaid expenses and other assets	87,978	233,194
Increase (decrease) in-		
Accounts payable	(29,592)	99,552
Accrued other expenses	(517,429)	501,746
Net cash provided (used) by operating activities	17,678,506	(2,192,875)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(112,327)	(107,783)
Decrease (Increase) in restricted cash	197,400	(200,052)

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

	Nine Months Ended Sept 30, 2004	Nine Months Ended Sept 30, 2003
Net cash provided (used) by investing activities	85,073	(307,835)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings (repayments), warehouse lines of credit	(17,497,961)	1,984,483
Repayment of long-term debt	(300,000)	(406,711)
Repayments, capital lease obligations	(52,789)	
Net cash provided (used) by financing activities	(17,850,750)	1,577,772
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(87,170)	(922,938)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,042,742	2,459,425
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 955,572	\$ 1,536,487
<u>SUPPLEMENTAL INFORMATION</u>		
Cash Paid For Income Taxes	\$ None	\$ None
Cash Paid For Interest	\$ 1,328,443	\$ 872,655

See accompanying notes to the unaudited financial statements.

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
September 30, 2004
(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.

Entrust Mortgage, Inc. was incorporated in Colorado in 1999 and is a wholly owned subsidiary of the Company. The Company's headquarters is located in Denver, Colorado.

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.

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

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. The Company typically 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.

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, 2003. 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 months ended and nine months ended September 30, 2004 are not necessarily indicative of the results that might be expected for the 12 months ending December 31, 2004.

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
September 30, 2004
(unaudited)

Principles of Consolidation

The accompanying financial statements include the accounts of the Company and its wholly owned subsidiary, Entrust Mortgage, Inc. All intercompany balances and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amount of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash, Restricted

In connection with the \$2,000,000 convertible promissory note agreement between Entrust Financial Services, Inc. and the lender, the Company has created a cash escrow account. Under an agreement entered into with the lender, the Company has ceased making further deposits into the escrow account and will only be required to make such deposits should the Company have a covenant violation with the lender.

Mortgage Loans Held for Sale

Mortgage loans held for sale are stated at the lower of cost or market determined on an aggregate loan basis. Mortgage loans are stated net of premiums or discounts and deferred net loan costs. Market value for mortgage loans covered by investor commitments is based on

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

commitment prices. Market value for uncommitted loans is based upon current delivery prices.

Loan Indemnification Reserve

Loans sold to investors by the Company and which met investor and agency underwriting guidelines at the time of sale may be subject to repurchase in the event of specific default by the borrower or subsequent discovery that underwriting standards were not met. The Company may, upon mutual agreement, indemnify the investor against future losses on such loans. The Company has established a reserve for losses related to these representations and warranties.

As of September 30, 2004, the Company has outstanding indemnification agreements with investors totaling \$405,086, requiring current aggregate monthly payments of \$54,316 and expiring October 2004 through July 2006. These liabilities are included as part of the loan indemnification reserve.

Revenue Recognition

Loan origination fees, net of direct costs, are deferred and recognized over the term of the loan or at the time the loan is sold. Gains or losses from the sale of mortgages are recognized when the proceeds are received from the purchaser. Interest income is accrued and credited to income based on the principal amount outstanding.

7

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
September 30, 2004
(unaudited)

Reclassifications

Certain reclassifications have been made to prior year balances to conform to the current year financial statement presentation.

Recently Issued Accounting Pronouncements

The Securities and Exchange Commission (SEC) has issued Staff Accounting Bulletin (SAB) 105, Loan commitments, on valuing mortgage loan rate lock commitment derivatives. The SAB states that a rate lock commitments are written options that should be recorded at zero or recorded as a liability if market interest rates move above the rate committed to the borrower.

The SAB is effective for loan commitments entered into April 1, 2004 or later. The SEC view is consistent with the Company's accounting policy in a stable or rising interest rate environment and would have no effect on the Company in such rate environments. However, the Company generally records a rate lock derivative asset in a falling rate environment, and this asset would not be recordable under the SAB. Accordingly, the impact is immaterial as of September 30, 2004. The Company expects that net income would decline during periods of falling interest rates due to the inability to record rate lock derivative assets.

NOTE 2 - WAREHOUSE LINES OF CREDIT

The Company has a \$12,500,000 warehouse line of credit agreement dated September 7, 2004, expiring September 30, 2005, which provides financing for the Company's origination of mortgage loans. The line of credit bears interest at LIBOR plus 2.50% to 3.75% depending on the underlying collateral. Purchase proceeds are withdrawn from the Company's bank account as funding proceeds from investors are deposited. The underlying mortgages and related documents and instruments collateralize the line of credit. At September 30, 2004, the outstanding principal balance of the warehouse line of credit amounted to \$7,172,334.

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

The agreement contains certain financial covenants, including maintenance of minimum tangible net worth and equity base, maximum debt to tangible net worth and equity base ratios, minimum current ratio, and limitations on transactions with affiliates and stockholder distributions, as defined in the agreement.

The Company entered into a \$30,000,000 Loan Purchase Agreement dated January 9, 2004, expiring on December 31, 2004, which provides 100% funding of the Company's mortgage loans originated. Entrust receives a fee for providing interim servicing functions until the ultimate sale of such loans to the ultimate investor and a service release premium paid by the ultimate investor. The Company has not recorded these loans as Mortgages Loans Held for Sale because these loans are being assigned and transferred at the time of closing. At September 30, 2004, the mortgage loans originated and held by the lender for sale to the ultimate investors is \$33,155,050. On September 9, 2004, Guaranty Bank and Trust Company notified the Company that the Loan Purchase Agreement would terminate on October 1, 2004. On September 29, 2004, Guaranty Bank and Trust Company extended the termination date to October 23, 2004. The Loan Purchase Agreement was terminated as of October 23, 2004.

8

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
 September 30, 2004
 (unaudited)

NOTE 3 -- CONVERTIBLE PROMISSORY NOTE

As of December 31, 2003, the Convertible Promissory Note (Note) had interest payable at 12% per annum, payable monthly, in arrears, and a 33% final interest payment only upon maturity or prepayment of the Note. 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, whereby 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, which as of the end of the year the Company was not in compliance with. In accordance with the Note, the Company had deposited \$500,000 into the sinking fund. As of April 1, 2004, the Company and the Note Holder agreed to restructure the Note by amending and restating the Note. In exchange for the restructuring, the Holder agrees to waive the Company's uncured Events of Default existing under the Note. In addition, the outstanding Principal Amount will bear interest at a rate of 12% per annum, payable monthly in arrears. The Principal Amount will be paid in 20 installments and ending on May 1, 2006 (\$50,000 shall be paid on the first day of each month commencing on April 1, 2004 and ending on September 1, 2004; and \$100,000 shall be paid on the first day of each month commencing on January 1, 2005 and ending on May 1, 2006). The Final Interest Payment had accrued interest of \$822,000 as of the date of the restructure. The Company agreed to pay the Note Holder \$500,000 upon execution of the agreement, \$22,000 before July 1, 2004 and \$100,000 on the first day of each month commencing on October 1, 2004 and ending on December 1, 2004. The Note Holder will have the right to convert the principal amount to common stock at \$.50 per share in lieu of payment of principal amount. The Company has the right to prepay the Note at any time.

NOTE 4 - INTANGIBLE ASSETS

Intangible assets represent the excess of acquisition costs over the fair value of the net assets of acquired businesses, which have been allocated to identifiable intangible assets as follows at September 30, 2004:

Description	Estimated Life	Acquisition Cost	Accumulated Amortization	Net Carrying Value
Client contracts	20 Years	\$1,200,000	\$(325,000)	\$ 875,000
Technology rights	10 Years	200,000	(107,000)	93,000
State licenses	40 Years	400,000	(55,500)	344,500
		\$1,800,000	\$(487,500)	\$1,312,500
		\$1,800,000	\$(487,500)	\$1,312,500

Amortization expense will amount to \$90,000 for each of the next five years.

NOTE 5 - INCOME TAXES

The Company has net operating losses of approximately \$4,585,323 available to offset future consolidated federal and state taxable income through 2023. Based upon the Company's current operating losses and the uncertainty as to future taxable income, a full valuation allowance has been provided for the Company's net deferred tax asset as of September 30, 2004.

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
September 30, 2004
(unaudited)

NOTE 6 - COMMITMENTS AND CONTINGENCIES

Commitments to Originate Loans

The Company regularly enters into commitments to originate loans at a future date subject to compliance with stated conditions. These commitments have off-balance sheet risk to the extent the Company does not have matching commitments to sell the loans, which expose the Company to market risk if interest rates change. The Company is also exposed to credit loss if the loan is originated and the mortgagor does not perform. The collateral upon extension of credit typically consists of a deed of trust in the mortgagor's residential property.

Separation Agreements

On July 5, 2002, the Company's Chairman of the Board resigned. 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. The Company and/or Entrust Mortgage shall make payments on the 15th day of each month thereafter for forty-eight consecutive months.

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

Use of Forward-Looking Statements

Some of the statements in this Form 10-QSB, including some statements in Management's Discussion and Analysis of Financial Condition and Results of Operations and Business are forward-looking statements about what may happen in the future. They include statements regarding our current beliefs, goals, and expectations about matters such as our expected financial position and operating results, our business strategy, and our financing plans. These statements can sometimes be identified by our use of forward-looking words such as anticipate, estimate, expect, intend, may, will, and similar expressions. We cannot guarantee that our forward-looking statements will turn out to be correct or that our beliefs and goals will not change. Our actual results could be very different from and worse than our expectations for various reasons. You are urged to carefully consider these factors, as well as other information contained in this Form 10-QSB and in our other periodic reports and documents filed with the Securities and Exchange Commission.

In our Form 10KSB filed with the Securities and Exchange Commission for the year ended December 31, 2003 and in the Footnotes to the unaudited Financial Statements for this report, we have identified critical accounting policies and estimates for our business.

Results of Operations

Three Months Ended September 30, 2004

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

Loan origination fees and gain on sale of loans increased from \$3.4 million for 2003 to \$5.5 million in 2004. The increase is attributable to the wholesale division increased funding from \$59.8 million in 2003 to \$107.8 million in 2004. In addition, the Company's retail division increased funding to \$33.5 million for 2004 compared to \$26.1 million in 2003. Direct cost increased from \$1.6 million in 2003 to \$2.9 million in 2004. Revenue realized on each wholesale loan sold during this period decreased by \$144 per unit compared to loans sold in the same period of 2003. The Company reduced the underwriting fee charged on each loan during this quarter. Direct cost on each wholesale loan increased \$134 per unit compared to the same period of 2003, primarily because of the increase fees paid to brokers.

Interest income increased from \$498,878 for 2003 to \$682,218 for 2004. Warehouse line of credit interest expense increased from \$317,194 in 2003 to \$491,598 in 2004.

Salaries, commissions and benefits increased from \$1.2 million in 2003 to \$1.7 million in 2004. This 38% increase is consistent with the increase in the numbers of employees and the continued investment in the expansion of the Company's wholesale organization.

The loan loss provision increased to \$438,284 in 2004 from \$299,270 in 2003. The Company's loan loss reserve increased because the wholesale loan volume increased during the period. The Company's loan loss reserve is based on management's most current estimate of risk exposure, using past experience and the most available economic circumstances.

Interest expense related to corporate borrowings decreased from \$251,157 in 2003 to \$72,268 in 2004. The decrease is the result of restructuring the \$2 million convertible promissory note from an effective annual interest rate of 45% to 12%.

General and administrative expenses decreased from \$357,715 in 2003 compared to \$262,107 in 2004. This decrease was primarily attributable to the Company spending less on third party services such as consultants.

The Company reported net income for the three months ending September 30, 2004 of \$128,699 (approximately \$0.04 per share on a fully diluted basis) compared to a net loss of \$305,693 (approximately \$0.12 per share on a fully diluted basis) for this same period in 2003.

Nine Months Ended September 30, 2004

Loan origination fees and gain on sale of loans increased from \$8.9 million for 2003 to \$13.9 million in 2004. The increase is attributable to the wholesale division increased funding from \$162.2 million in 2003 to \$256 million in 2004. In addition, the Company's retail division increased funding to \$93.0 million for 2004 compared to \$68.1 million in 2003. Direct cost increased from \$4.0 million in 2003 to \$7.0 million in 2004. Revenue realized on each wholesale loan sold during this period increased by \$136 per unit compared to loans sold in the same period of 2003. Direct cost on each wholesale loan increased approximately \$300 per unit compared to the same period of 2003 primarily because of the increase fees paid to brokers. Revenue realized on each retail loan sold during this period increased by \$250 per unit compared to loans sold in the same period of 2003. Direct cost on each retail loan increased approximately \$900 per unit compared to the same period of 2003 primarily because of the increase fees paid to affiliates and brokers.

Interest income increased from \$1.4 million for 2003 to \$1.5 million for 2004. Warehouse line of credit interest expense increased from \$881,611 in 2003 to \$1,055,209 in 2004.

Salaries, commissions and benefits increased from \$3.5 million in 2003 to \$4.3 million in 2004. This increase is consistent with the increase in the numbers of employees and loan officers originating loans. In addition, the Company continues to invest in the expansion of the Company's sales and operations organization.

The loan loss provision decreased to \$1.2 million in 2004 from \$2.2 million in 2003. 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. The decrease is primarily attributable to the \$1.4 million change in estimate for the loan loss reserve recorded during this period in 2003. In addition, the decrease was offset by an increase in wholesale loan fundings during the period compared to the same period last year.

Interest expense related to corporate borrowings decreased from \$754,643 in 2003 to \$389,666 in 2004. The decrease is the result of restructuring the \$2 million convertible promissory note from an effective annual interest rate of 45% to 12%.

General and administrative expenses decreased from \$1,009,975 in 2003 compared to \$679,801 in 2004. This decrease was primarily attributable to the Company spending less on third party services such as consultants.

The Company reported net income for the nine months ending September 30, 2004 of \$179,877 (approximately \$0.06 per share on fully diluted basis) compared to a net loss of \$2,801,527 (approximately \$1.11 per share on a fully diluted basis) in 2003.

Liquidity and Capital Resources

Loan origination increased substantially for the quarter ending in 2004 compared to 2003. The increase is attributable to the wholesale division increased funding from \$162.2 million in 2003 to \$256 million in 2004. In addition, the Company's retail division increased funding to \$93.0 million for 2004 compared to \$68.1 million in 2003.

As a consequence, during the nine months ended September 30, 2004, net cash provided by operating activities was \$17.7 million compared to net cash used by operating activities of \$2.2 million in 2003. Net cash provided in operating activities in 2004 is impacted primarily by the origination of and proceeds from the sale of mortgage loans held for sale.

Net cash used by investing activities to purchase property and equipment was approximately \$108,000 in 2003 compared to approximately \$112,327 in 2004. In addition, there was a decrease in restricted cash during 2004 of approximately \$200,000, which was used to pay accrued interest.

Net cash used for financing activities in 2004 was \$17.85 million and in 2003 net cash provided by financing activities was \$1.6 million.

The decrease in net cash flow from operating, financing, and investing activities was less than \$90,000 in 2004 compared to a decrease in cash of approximately \$900,000 for the same period in 2003.

The Company's warehouse credit facility provides for a maximum borrowing capacity of \$12.5 million. We currently have \$7.1 million outstanding on this facility.

The Company entered into a \$30,000,000 Loan Purchase Agreement dated January 9, 2004, expiring on December 31, 2004, which provides 100% funding of the Company's mortgage loans originated. Entrust receives a fee for providing interim servicing functions until the ultimate sale of such loans to the ultimate investor and a service release premium paid by the ultimate investor. The Company has not recorded these loans as Mortgages Loans Held for Sale because these loans are being assigned and transferred at the time of closing. At September 30, 2004, the mortgage loans originated and held by the lender for sale to the ultimate investors is \$33,155,050. On September 9, 2004, Guaranty Bank and Trust Company notified the Company that the Loan Purchase Agreement would terminate on October 1, 2004. On September 29, 2004, Guaranty Bank and Trust Company extended the termination date to October 23, 2004. The Loan Purchase Agreement was terminated as of October 23, 2004.

At the present time, the Company is using a combination of sources for placement of its mortgages while it searches for a replacement loan purchase arrangement. The Company considers such a replacement to be necessary for its long-term growth.

Short term capital has been sufficient to meet our current growth trends, but to continue to grow at our projected pace, we will need to seek equity investments to keep our debt to equity ratios in line with our warehouse credit facilities. There are no plans, proposals, arrangements or understandings with respect to the sale or issuance of additional securities or for the acquisition of additional equity investments. We do not intend to pay dividends in the foreseeable future.

As of April 1, 2004, the Company and the Convertible Promissory Note Holder agreed to restructure the Note by amending and restating the Note. In exchange for the restructuring, the Holder agrees to waive the Company's uncured Events of Default existing under the Note. In addition, the outstanding Principal Amount will bear interest at a rate of 12% per annum, payable monthly in arrears. The Principal Amount will be paid in 20 installments and ending on May 1, 2006 (\$50,000 shall be paid on the first day of each month commencing on April 1, 2004 and ending on September 1, 2004; and \$100,000 shall be paid on the first day of each month commencing on January 1, 2005 and ending on May 1, 2006). The Final Interest Payment had accrued interest of \$822,000. The Company agreed to pay the Note Holder \$500,000 upon execution of the agreement, \$22,000 before July 1, 2004 and \$100,000 on the first day of each month commencing on

Edgar Filing: ENTRUST FINANCIAL SERVICES INC - Form 10QSB

October 1, 2004 and ending on December 1, 2004. The Note Holder will have the right to convert the principal amount to common stock at \$.50 per share in lieu of payment of principal amount. The Company has the right to prepay the Note at any time.

ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this quarterly report on Form 10-QSB, we evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)). That evaluation was performed under the supervision and with the participation of its management, including its Chief Executive Officer and its Chief Financial Officer. Based on that evaluation, our Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in timely alerting him to material information relating to Entrust Financial Services required to be included in its periodic SEC filings.

(b) Changes in Internal Control over Financial Reporting

The Company has made no significant change in its internal control over financial reporting during the most recent fiscal quarter covered by this report on Form 10-QSB that has materially affected, or is reasonably likely to materially affect, its internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

There are no material pending legal proceedings, which the Company is a party other than ordinary routine litigation incidental to its business.

ITEM 2. Changes in Securities and Use of Proceeds

None

ITEM 3. Defaults Upon Senior Securities

None

ITEM 4. Submission of Matters to a Vote of Security Holders

None

ITEM 5. Other Information

None

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits: see the attached Exhibit Index following the signature page.

(b) Reports on Form 8-K: We filed one Form 8-K on September 14, 2004 and October 4, 2004, which discussed the termination of the loan purchase agreement with Guaranty Bank and Trust.

15

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.

Date: November 8, 2004

Entrust Financial Services Inc.

By: /s/ Scott J. Sax
Scott J. Sax
Chief Executive Officer

By: /s/ Jeffrey D. Rudolph
Jeffrey D. Rudolph
Chief Financial Officer

16

EXHIBIT INDEX
Form 10-QSB
Quarter Ended September 30, 2004

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of CEO pursuant to Sec. 302
31.2	Certification of CFO pursuant to Sec. 302
32.1	Certification of CEO pursuant to Sec. 906
32.2	Certification of CFO pursuant to Sec. 906

