

ENTRUST FINANCIAL SERVICES INC
Form 10QSB
August 04, 2005

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 June 30, 2005

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 June 30, 2005</u>
Common Stock, \$.0000001 par value, net of Treasury Stock	2,612,295

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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.

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PART 1 - FINANCIAL INFORMATION

ITEM 1. Financial Statements:

ENTRUST FINANCIAL SERVICES, INC.
CONSOLIDATED BALANCE SHEETS

	June 30, 2005 (unaudited)	December 31, 2004
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 632,869	\$ 1,101,155
Cash, restricted	--	2,805
Accounts receivable	90,906	54,796
Mortgage loans held for sale	26,323,433	42,618,137
Prepaid expenses and other current assets	61,743	76,995
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Total current assets	27,108,951	43,853,888
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Property and equipment, net	355,554	409,107
	<hr/>	<hr/>
OTHER ASSETS		
Intangibles, net	1,216,550	1,279,883
Deposits and Other assets	288,560	279,559
	<hr/>	<hr/>
Total other assets	1,505,110	1,559,442
	<hr/>	<hr/>
TOTAL ASSETS	\$ 28,969,615	\$ 45,822,437
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<u>LIABILITIES AND STOCKHOLDERS EQUITY</u>		
CURRENT LIABILITIES		
Warehouse lines of credit	\$ 25,436,454	\$ 41,662,386
Accounts payable	307,459	120,242
Accrued other expenses	411,181	876,139
Loan indemnification reserve, current portion	569,067	530,804
Convertible Promissory Note, current portion	1,500,000	1,200,000
Capital lease obligations, current portion	70,622	70,622
	<hr/>	<hr/>
Total current liabilities	28,294,783	44,460,193
Convertible Promissory Note, less current portion	--	500,000
Loan indemnification reserve, less current portion	1,060,453	889,335
Capital lease obligations, less current portion	29,434	63,918
	<hr/>	<hr/>
Total liabilities	29,384,670	45,913,446
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STOCKHOLDERS EQUITY		
Common stock, \$.0000001 par value, 50,000,000 shares authorized, 2,612,295 issued and outstanding for 2005 and 2,612,295 issued and outstanding for 2004	1	1
Paid-in capital	7,605,555	7,605,555
Retained earnings	(8,020,611)	(7,696,565)
	<hr/>	<hr/>
Total stockholders equity	(415,055)	(91,009)
	<hr/>	<hr/>

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	June 30, 2005 (unaudited)	December 31, 2004
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	\$ 28,969,615	\$ 45,822,437

See accompanying notes to the unaudited financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
REVENUE				
Loan origination fees and gain on sale of loans	\$ 4,025,943	\$ 4,754,224	\$ 8,517,252	\$ 8,411,284
Direct costs of loan origination	(2,096,075)	(2,393,639)	(4,470,688)	(4,120,283)
Interest income	377,869	427,780	1,053,805	834,633
Interest expense, warehouse and other debt	(340,496)	(307,429)	(848,001)	(552,718)
Total revenue	1,967,241	2,480,936	4,252,368	4,572,916
EXPENSES				
Salaries, commissions, and benefits	1,423,460	1,404,569	2,740,412	2,578,531
Occupancy, equipment and communication	137,557	187,768	331,571	336,910
General and administrative	201,272	229,896	529,374	435,025
Provision for loan losses	390,620	424,927	737,153	742,835
Interest expense, convertible promissory note	44,854	80,727	112,809	327,292
Depreciation expense	30,907	27,716	61,760	62,817
Amortization expense	31,667	22,500	63,335	45,000
Total expenses	2,260,337	2,378,103	4,576,414	4,528,410
INCOME (LOSS) BEFORE INCOME TAXES	(293,096)	102,833	(324,046)	44,506
PROVISION FOR INCOME TAXES	--	--	--	--
NET LOSS	\$ (293,096)	\$ 102,833	\$ (324,046)	\$ 44,506
Basic Earnings per share	\$ (0.11)	\$ 0.04	\$ (0.12)	\$ 0.02
Diluted earnings per share	\$ (0.11)	\$ 0.03	\$ (0.12)	\$ 0.01

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	Three Months Ended		Six Months Ended	
Basic Weighted Average Shares Outstanding	2,612,295	2,581,795	2,612,295	2,581,795
Diluted Weighted Average Shares Outstanding	2,704,795	3,011,795	2,704,795	3,011,795

See accompanying notes to the unaudited financial statements.

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

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ (324,046)	\$ 44,506
Non-cash items-		
Depreciation and amortization	125,094	107,817
Provision for loan losses	210,380	255,751
(Increase) decrease in-	1,500	
Accounts receivable	(36,110)	
Mortgage loans held for sale	16,294,702	(120,822)
Prepaid expenses and other assets	5,253	14,573,653
Increase (decrease) in-	(10,108)	
Accounts payable	187,216	
Accrued other expenses	(464,958)	(2,175)
Net cash provided (used) by operating activities	15,997,531	(459,849)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property and equipment	(8,208)	(95,763)
Decrease (Increase) in restricted cash	2,805	198,540
Net cash provided (used) by investing activities	(5,403)	102,777
CASH FLOWS FROM FINANCING ACTIVITIES		
Net borrowings (repayments), warehouse lines of credit	(16,225,932)	(14,345,663)
Repayment of long-term debt	(500,000)	(150,000)
Proceeds from Borrowings	300,000	--
Repayments, capital lease obligations	(34,482)	(34,433)
Net cash provided (used) by financing activities	(16,460,414)	(14,530,096)

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	<u>Six Months Ended June 30, 2005</u>	<u>Six Months Ended June 30, 2004</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(468,286)	(37,046)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	1,101,155	1,042,742
CASH AND CASH EQUIVALENTS, END OF PERIOD	<u>\$ 632,869</u>	<u>\$ 1,005,696</u>
<u>SUPPLEMENTAL INFORMATION</u>		
Cash Paid For Income Taxes	<u>\$ None</u>	<u>\$ None</u>
Cash Paid For Interest	<u>\$ 345,785</u>	<u>\$ 910,155</u>

See accompanying notes to the unaudited financial statements.

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ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(unaudited)

NOTE 1 - ORGANIZATION AND GOING CONCERN

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. Entrust Mortgage engages primarily in the origination and wholesale purchase of non-conforming residential mortgage loans in thirty-eight states. The Company's headquarters is located in Denver, Colorado.

The Company has experienced operating losses for the year ended December 31, 2004 and quarter ended June 30, 2005 and has stockholder deficit for the same periods. The Company is in default under its current warehouse line of credit and needs to raise additional capital to correct the default. These matters raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 2 - SUBSEQUENT EVENT

On July 26, 2005, the shareholders of Entrust Financial Services, Inc. ratified and approved the following resolutions at a Special Meeting of the shareholders:

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1. Approval of the Stock Purchase Agreement (the Entrust Mortgage Stock Purchase Agreement) by and among the Company, Entrust Mortgage, Inc., a wholly-owned subsidiary of the Company (Entrust Mortgage) and BBSB, LLC (BBSB) and the transactions contemplated thereby, including the sale of all shares of Entrust Mortgage to BBSB in exchange for the cancellation of any and all obligations of the Company to BBSB and Entrust Mortgage and the assumption of certain obligations of the Company to third-parties (the Entrust Mortgage Sale).
2. Approval of the sale and issuance, in a private placement to Arnold P. Kling and R&R Biotech Partners, LLC (collectively, the ENFN Stock Purchasers), of 49,500,000 shares of the Company's common stock in exchange for aggregate gross proceeds to Entrust Financial of \$500,000 (the Entrust Financial Stock Sale).
3. Approval of an amendment to the Articles of Incorporation of the Company to increase the number of authorized common stock to One Hundred Million (100,000,000) in order to complete the Entrust Financial Stock Sale (the Articles Amendment).

On July 31, 2005, the sale of Entrust Mortgage, Inc. to BBSB was completed. After the closing of the Entrust Mortgage Sale, Entrust Financial Services has no operations.

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ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(unaudited)

The closing date of the Entrust Financial Stock Sale has not been scheduled, but is expected to occur on or before August 5, 2005. The Entrust Financial Stock Sale is subject to a number of closing conditions as more fully set forth in the proxy statement distributed in connection with the Special Meeting of the shareholders. The ENFN Stock Purchasers have not yet determined the operations, if any, of Entrust Financial Services following the closing of the Entrust Financial Stock Sale.

NOTE 3 - SALE OF ENTRUST MORTGAGE

On July 31, 2005, the sale of Entrust Mortgage, Inc. to BBSB was completed. After the closing of the Entrust Mortgage Sale, Entrust Financial Services has no operations.

The closing date of the Entrust Financial Stock Sale has not been scheduled, but is expected to occur on or before August 5, 2005. The Entrust Financial Stock Sale is subject to a number of closing conditions as more fully set forth in the proxy statement distributed in connection with the Special Meeting of the shareholders. The ENFN Stock Purchasers have not yet determined the operations, if any, of Entrust Financial Services following the closing of the Entrust Financial Stock Sale.

The shareholders of the Company did not receive any consideration in the Entrust Mortgage Sale, but will receive a one time aggregate dividend of \$400,000 if both the Entrust Mortgage Sale and the Entrust Financial Stock Sale are completed, as described in more detail below.

NOTE 4- SALE OF STOCK OF ENTRUST FINANCIAL

On May 12, 2005 the Company entered into a Common Stock Purchase Agreement (the Stock Purchase Agreement) by and among the Company, Entrust Mortgage, and the ENFN Stock Purchasers pursuant to which the ENFN Stock Purchasers have agreed to purchase 49,500,000 newly issued shares of Common Stock of the Company for an aggregate purchase price of \$500,000 in cash (the Entrust Financial Stock Sale). The Company has declared and set a record date of July 25, 2005 for a special dividend, which is contingent upon the closing pursuant to the Stock Purchase Agreement (the Special Dividend), in an aggregate amount equal to \$400,000.00. The Company intends to pay such Special Dividend as soon as practicable following the closing.

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The Entrust Financial Stock Sale is subject to a number of closing conditions as more fully set forth in the proxy statement distributed in connection with the Special Meeting of the shareholders. The closing of this transaction have not been scheduled but is expected to take place on or before to August 5, 2005.

NOTE 5 - BASIS OF PRESENTATION

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.

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ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(unaudited)

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, 2004. 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 six months ended June 30, 2005 are not necessarily indicative of the results that might be expected for the 12 months ending December 31, 2005.

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.

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(unaudited)

Mortgage Loans Held for Sale and Revenue Recognition

Mortgage loans held for sale are carried at the lower of cost or market determined on an aggregate loan basis. Market value for mortgage loans covered by investor commitments is based on commitment prices. Market value for uncommitted loans is based on current delivery prices.

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 based upon the difference between the selling price and carrying value of the related loans upon sale. Interest income is accrued to income based on the principal amount outstanding.

Loans are considered sold when the Company surrenders control over the financial assets. Control is considered to have been surrendered when the transferred assets have been isolated from the Company, beyond the reach of the Company and its creditors; the purchaser obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets; and the Company does not maintain effective control over the transferred assets through an agreement that both entitles and obligates the Company to repurchase or redeem the transferred assets before their maturity. The Company typically considers the above criteria to have been met upon acceptance and receipt of sales proceeds from the purchaser.

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 June 30, 2005, the Company has outstanding indemnification agreements with investors totaling \$569,067, requiring current aggregate monthly payments of \$56,316 and expiring May 2005 through July 2006. These liabilities are included as part of the loan indemnification reserve.

Reclassifications

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

Recently Issued Accounting Pronouncements

In December 2004, the FASB issued FASB Statement No. 123 (Revised), *Share-Based Payment*. SFAS No. 123R requires public entities to measure the cost of stock-based compensation based on the grant date fair value of the award, and is effective for interim periods beginning after June 15, 2005. The financial statement impact of adopting SFAS 123R is not expected to differ materially from historical proforma disclosures. Management is evaluating the transition alternatives, all of which require compensation expense to be included in net income in 2005, and valuation methodologies allowed under the new standard.

ENTRUST FINANCIAL SERVICES, INC.
NOTES TO FINANCIAL STATEMENTS
June 30, 2005
(unaudited)

NOTE 6 - WAREHOUSE LINES OF CREDIT

The Company has a \$14,000,000 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 June 30, 2005, the outstanding principal balance of the warehouse line of credit amounted to \$25,436,454.

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. As of June 30, 2005, the Company was in default under certain financial covenants. The Company is currently having discussions with the lender to resolve all outstanding issues.

NOTE 7 -- CONVERTIBLE PROMISSORY NOTE

As of December 31, 2003, the Convertible Promissory Note (Note) had interest payable monthly in arrears at 12% per annum, and additional interest at 33% per annum payable 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.

As of April 1, 2004, the Company and the Note Holder agreed to amend and restate the Note. In exchange for the restructuring, the Holder agreed to waive the Company's uncured Events of Default existing under the Note. Effective with the amendment, the outstanding principal balance will bear interest at 12% per annum, payable monthly in arrears. The principal balance is payable in 20 installments ending on May 1, 2006 (\$50,000 is payable on the first day of each month commencing on April 1, 2004 and ending on September 1, 2004; and \$100,000 is payable on the first day of each month commencing on January 1, 2005 and ending on May 1, 2006). The promissory note had accrued interest of \$822,000 as of the date of the restructure. The Company agreed to pay \$500,000 of the interest 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 has 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.

On May 26, 2005, the Company entered into a Second Amended and Restated Promissory Note pursuant to which BBSB agreed to loan an additional \$300,000 to the Company under the terms of the existing Amended and Restated Promissory Note. The terms of the Note are substantially similar to the terms of the Prior Note with the exception that (i) it shall be an event of default under the terms of the Note if the Company's shareholders do not approve the proposed sale of Entrust Mortgage to BBSB under the terms of a Stock Purchase Agreement and (ii) BBSB has agreed to waive the \$100,000 payment that would have been due from the Company to BBSB on June 1, 2005 under the terms of the Prior Note.

NOTE 8 - 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 June 30, 2005:

Description	Estimated Life	Acquisition Cost	Accumulated Amortization	Net Carrying Value
Client contracts	15 Years	\$1,200,000	\$(381,850)	\$ 818,150
Technology rights	10 Years	200,000	(117,000)	83,000
State licenses	15 Years	400,000	(84,600)	315,400
		<u>\$1,800,000</u>	<u>\$(583,450)</u>	<u>\$1,216,550</u>