

FIRST FINANCIAL CORP /TX/
Form 10QSB
November 20, 2006

UNITED STATES
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 quarterly period ended September 30, 2006

TRANSITION REPORT UNDER SECTION 13 OR 15(D) ON THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file number 0-5559

FIRST FINANCIAL CORPORATION

(Exact name of small business issuer 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)

Issuer's telephone number (254) 757-2424

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes No

Number of shares of the Issuer's Common Stock outstanding on October 31, 2006 was 173,528.

Transitional Small Business Disclosure Format (check one) Yes No

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FIRST FINANCIAL CORPORATION
September 30, 2006

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Item 1. Financial Statements

First Financial Corporation
 Consolidated Balance Sheet
 September 30, 2006
 (Unaudited)

| | |
|--|-------------|
| Assets | |
| ----- | |
| Cash and cash equivalents | \$ 171,624 |
| Restricted cash | - |
| Accounts receivable | 87,103 |
| Marketable investment securities | 290,360 |
| Restricted marketable investment securities | - |
| Real estate held for investment, at cost | - |
| Mortgage loans | 72,533 |
| Property and equipment | 79,144 |
| Other assets | 197,913 |
| Total Assets | \$898,677 |
| Liabilities and Stockholders' Deficit | |
| ----- | |
| Notes on line of credit | \$ 0 |
| Notes payable | 2,746,569 |
| Accounts payable | 246,843 |
| Estimated reserve for indemnifications and early payment default losses | 2,595,394 |
| Estimated reserve for losses under servicing agreements | - |
| Estimated reserve for losses under insurance policies | - |
| Other liabilities | 113,574 |
| Total Liabilities | 5,702,380 |
| Stockholders' deficit: | |
| 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 | (5,406,809) |
| Accumulated other comprehensive income: | |
| Unrealized gain (loss) on marketable securities, net of tax | 118,713 |
| | (4,768,394) |
| Less: Treasury stock - at cost | (35,309) |
| Total Stockholders' Deficit | (4,803,703) |
| Total Liabilities and Stockholders' Deficit | \$ 898,677 |
| See accompanying notes to consolidated financial statements. | |

First Financial Corporation
Consolidated Statements of Income
Three months and Six months ended September 30, 2006 and 2005
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------------|------------------------------------|----------------|
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Revenues: | | | | |
| Loan administration | \$ - | \$ 1,279,236 | \$ 1,086,807 | \$ 3,592,740 |
| Interest income | - | 226,533 | 5,764 | 877,570 |
| Oil and gas royalties | 271,243 | 11,301 | 290,460 | 40,128 |
| Other income | 7,399 | 139,060 | 1,304,514 | 658,837 |
| Total Revenues | 278,642 | 1,656,130 | 2,687,545 | 5,169,275 |
| Expenses: | | | | |
| Salaries and related expenses | 46,637 | 1,197,713 | 1,375,855 | 3,527,057 |
| Interest expense | 45,003 | 230,623 | 159,331 | 822,790 |
| Provision for loan losses | - | 1,913,002 | 1,936,667 | 2,568,010 |
| Impairment of assets | 43,940 | - | 851,177 | - |
| Other operating expenses | 7,140 | 864,841 | 1,572,207 | 2,511,121 |
| Total Expenses | 142,720 | 4,206,179 | 5,895,237 | 9,428,978 |
| Income (loss) before income other income, and provision for income tax expense | 135,922 | (2,550,049) | (3,207,692) | (4,259,703) |
| Other non-operating income | | | | |
| Net gain from settlement of note payable | 620,000 | - | 620,000 | - |
| Total Other Income | 620,000 | - | 620,000 | - |
| | | | | |
| Income (loss) before provision for income tax | 755,922 | (2,550,049) | (2,587,692) | (4,259,703) |
| | | | | |
| Federal income taxes | - | - | 64 | - |
| Net income (loss) | 755,922 | (2,550,049) | (2,587,756) | (4,259,703) |
| Other comprehensive income: | | | | |
| Unrealized holding gains (losses) | (78,835) | 3,440 | 117,334 | (16,955) |
| Comprehensive income (loss) | \$ 677,087 | \$ (2,546,609) | \$ (2,470,422) | \$ (4,276,658) |
| Income Per Common Share | \$ 3.90 | \$ (14.68) | \$ (14.24) | \$ (24.65) |

See accompanying notes to consolidated financial statements.

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First Financial Corporation
Consolidated Statement of Cash Flows
(Unaudited)

| | Nine Months Ended | |
|---|-------------------|----------------|
| | <u>2006</u> | <u>2005</u> |
| Cash flows from operating activities: | | |
| Net income (loss) | \$ (2,587,756) | \$ (4,259,704) |
| Adjustments to reconcile net income(loss) to net cash used by operating activities: | | |
| Depreciation | 1,345,026 | 245,101 |
| Provision for loan losses | 1,936,667 | 2,568,010 |
| Loan and insurance losses paid | (1,785,156) | (2,409,143) |
| Realized (gains) losses on marketable investment securities | (11,669) | (1,214) |
| Gain on sale of real estate held for investment | (696,164) | |
| Net (increase) decrease in accounts receivable | 84,893 | 384,322 |
| Net (increase) decrease in other assets | 325,319 | 88,518 |
| Net increase (decrease) in accounts payable | (150,686) | (69,569) |
| Net increase (decrease) in reserve for losses under insurance policies | - | (308,696) |
| Net increase (decrease) in other liabilities | (380,676) | (252,082) |
| (Increase) decrease in restricted cash used in operating activities - net | - | 479,495 |
| Mortgage loans funded | (70,392,273) | (236,054,333) |
| Mortgage loans sold | 86,221,199 | 247,140,071 |
| Increase (decrease) in mortgage loans participations sold | (15,669,454) | (1,850,227) |
| Other | 1,381 | 2,137 |
| Net cash provided (used) for operating activities | (1,759,349) | 5,702,687 |
| Cash flows from investing activities: | | |
| Proceeds from sale of marketable investment securities | 61,669 | 2,224,741 |
| Purchases of marketable investment securities | (160,912) | (904,648) |
| Unrealized holding (gain) loss | (61,823) | (16,955) |
| Proceeds from sale of real estate held for investment | 1,250,000 | |
| Purchase of property and equipment | (78,258) | (71,530) |
| Principal collections on mortgage loans | 53,708 | 9,453 |
| (Increase) decrease in deferred gain on sale of property & equipment | - | 102,152 |
| Net cash provided (used) for investing activities | 1,064,383 | 1,343,213 |
| Cash flows from financing activities: | | |
| Net change in short term borrowings | | (9,136,421) |
| Proceeds from notes payable | 1,138,343 | 1,703,086 |
| Payments on notes payable | (1,826,240) | (174,295) |
| Net cash used for financing activities | (687,897) | (7,607,630) |
| Net increase (decrease) in cash and cash equivalents | (1,382,863) | (561,730) |
| Cash and cash equivalents at beginning of year | 1,554,487 | 1,675,465 |
| Cash and cash equivalents at end of period | \$ 171,624 | \$ 1,113,735 |
| Supplemental Disclosure of Cash Flow Information | | |
| Interest Paid | \$ 214,784 | \$ 833,415 |

See accompanying notes to consolidated financial statements.

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 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, assuming that the Company will continue as a going concern. 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.

The results of operations and changes in cash flow for the nine-month period ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year or any future period.

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

2 - Going Concern

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. At September 30, 2006, the Company has unrestricted cash and cash equivalents of \$.17 million and an accumulated deficit of \$5.4 million. At December 31, 2005, the Company had cash and cash equivalents of \$1.6 million and an accumulated deficit of \$2.3 million. The Company incurred a net loss before income taxes of \$2.587 million during the nine months ended September 30, 2006 and a net loss before income taxes of \$5.477 million during the year ended December 31, 2005.

First Preference Mortgage Corporation ("FPMC"), a wholly owned subsidiary of the Company, had incurred net losses of \$4.9 million and \$2.46 million for the years ended December 31, 2005 and 2004, respectively.

In prior years, FPMC's primary funding source was a mortgage warehouse line of credit from Colonial Bank. During 2005, the Company was unable to maintain certain borrowing covenants (i.e. minimum adjustable tangible net worth) resulting in the Company being unable to borrow money under the line of credit to fund mortgage loan originations. Colonial Bank terminated the line of credit, effective March 31, 2006.

In September 2005, FPMC entered into a Loan Participation Agreement with Citizens State Bank of Woodville, Texas ("CSB"). David W. Mann, the Company's chief executive officer and controlling beneficial owner, is also chief executive officer and controlling beneficial owner of CSB. The sale of participations to CSB was the Company's only source of funding after October 2005. On April 30, 2006 CSB terminated its Loan Participation Agreement with FPMC.

In order to participate in the FHA mortgage insurance program, FPMC is required to maintain a minimum net worth requirement. As of December 31, 2005, FPMC was below the minimum net worth requirement of the Department of Housing and Urban Development ("HUD"), as a result of which FPMC became ineligible for participation in the HUD mortgage insurance programs.

The significant losses for the nine months ended September 30, 2006, the years ended December 31, 2005 and 2004, the inability to fund new loan originations through a mortgage warehouse line or participation agreement, and the violation of the minimum net worth requirement of HUD, create significant doubt about FPMC's ability to continue as a going concern. Management has discontinued the mortgage operation, the Company's only significant source of revenue, with no new mortgage loans being funded after April 28, 2006. The financial statements do not include any adjustments that might be necessary if FPMC is unable to continue as a going concern.

The revenue from FPMC represents over 90% of the Company's total revenue. Therefore, the financial condition of FPMC creates significant doubt about the Company's ability to continue as a going concern.

3 - Notes Payable

During the month of June 2006, and subsequently, FPMC did not make payment to CitiMortgage, Inc. ("CMI"), Washington Mutual Bank, FA ("Washington Mutual") or the Department of Housing and Urban Development ("HUD") as required by the agreements described in Results of Operations. The last payments due in May 2006 under each of these three agreements were remitted in May 2006. The amounts payable to CMI and Washington Mutual are zero interest obligations and are reflected on the accompanying balance sheet as notes payable. Upon FPMC's default of these two notes, FPMC raised the note payable balance to reflect the total of the future scheduled payments. Previously, the Company reflected these notes on a net present value basis. This resulted in a total increase to notes payable in the amount of \$223,822. This increase was reflected in the previously reported amounts for June 2006.

On September 15, 2006, FPMC entered into a Release and Settlement Agreement with Washington Mutual. For consideration of \$65,000 paid by FPMC, Washington Mutual released FPMC of any claims, complaints, liabilities, obligations, promises, agreements, contracts and causes of action, against FPMC. Notes payable was decreased by \$685,000.

4 - Earnings Per Share

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

5 - 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 \$8 million 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; therefore, no asset is reflected on the Company's balance sheet for the net operating loss carryforward benefits.

6 - Subsequent Event

The Company and its errors and omission insurer recently agreed to settle claims with respect to errors occurring in the origination of loans for \$482,776, receipt of which is expected in the near future.

7 - Contingencies

In the ordinary course of business, the Company sells loans to institutional investors without recourse that may have to be subsequently repurchased due to defects that occurred during the origination of the loan. In addition, mortgage loans sold to investors are subject to repurchase or indemnification if the loans become a specified number of months delinquent within a specified period of time after the loans are sold (i.e., early payment default). When a loan sold to an investor without recourse fails to perform, the investor will typically review the loan file to determine whether defects in the origination process occurred. If a defect is identified, the Company may be required to either repurchase the loan or indemnify the investor for losses sustained. If there are no defects, the Company has no commitment to repurchase the loan. The Company has accrued for this potential loss exposure as further discussed in Item 2. At September 30, 2006, the estimated reserve for indemnifications and early payment default losses was \$2,595,394.

On August 28, 2006, CitiMortgage, Inc. ("CMI") filed suit in the United States District Court for the Eastern District of Missouri against FPMC, David W. Mann and Citizens Mortgage Corporation ("CMC"). CMC is a subsidiary of Citizen's State Bank, the president and chief executive officer of which is Mr. Mann and the parent company of which is majority-owned by Mr. Mann and his affiliates. This litigation results from defaults by FPMC in the repayment to CMI of amounts required to be paid by FPMC under its July 20, 2006 Workout and Forbearance Agreement with CMI and under the underlying loan agreements, as described under "Results of Operations" in Item 2 of Part I of this report. Amounts claimed by CMI to be payable under these agreements total approximately \$3,500,000. The sum of the amounts reflected on the accompanying balance sheet under notes payable and under estimated reserve for loan losses that relate to loans sold to CMI is approximately \$3,500,000. CMI also makes claims in this litigation against FPMC, Mr. Mann and CMC based on allegations that FPMC made transfers to CMC of assets related to its mortgage operations without receiving reasonably equivalent value in exchange. The amount of these claims is not quantified. In answer to this suit, FPMC has filed a general denial. CMS has moved to dismiss the suit for lack of personal jurisdiction and improper venue and Mr. Mann has moved to dismiss the suit for lack of personal jurisdiction.

Item 2. Management's Discussion and Analysis or Plan of Operation

Results of Operations

The Company had a net loss of \$(2,587,692) for the nine months ended September 30, 2006 compared to a net loss of \$(4,259,703) for the same period in 2005. The Company had a net income of \$755,922 for the three months ended September 30, 2006 compared to a net loss of \$(2,550,049) for the same period in 2005. As a result of the discontinuance of the Company's mortgage operations after April 28, 2006 described under "Liquidity and Capital Resources," the Company's total expenses during the quarter ended September 30, 2006 have decreased to \$140,000 from \$4.2 million for the same time period last year. The Company's only material income during the September 30, 2006 quarter was a \$620,000 gain from the settlement of a debt and \$270,000 as a lease bonus on a new oil and gas lease covering certain real property owned by the company. There were no mortgage loans funded in the quarter ended September 30, 2006 compared to \$72 million in mortgage loans funded during the same period in 2005. During the nine months ended September 30, 2006, FPMC funded approximately \$70 million in mortgage loans compared to approximately \$236 million during the same period in 2005.

During the quarter ended September 30, 2006, there were also no loan administration revenues and no interest revenue compared to \$1,279,236 and \$226,533 respectively for the same period in 2005. Loan administration revenues were \$1,086,807 for the first nine months of 2006 compared to \$3,592,740 for the same period of 2005. Interest income for the nine months ended September 30, 2006 amounted to \$5,764 compared to \$877,570 for the same period in 2005. FPMC earned interest from the date the mortgage loan was closed until the date the mortgage loan was sold to investors.

Also, interest revenue and interest expense reflect a lower amount for the nine months ended September 30, 2006 compared to the same time period for 2005 because starting October 1, 2005, the Company sold participations in the loans up to 99% of the face value of the loan to CSB. Through September 30, 2005, the loans held for sale were being reported as an asset and the amount owed on those loans to Colonial Bank, FPMC's warehouse line of credit lender, were reported as a liability. Beginning October 1, 2005, the loans held for sale were reported net of the participations sold. The interest earned and the interest owed on the loans by the Company was based on the remaining 1% interest held by the Company.

During the third quarter of 2006, the Company entered into a new oil and gas lease resulting in oil and gas royalties for the quarter ended September 30, 2006 of \$271,243 compared to \$11,301 for the same period in 2005. Oil and gas royalties for the nine months ended September 30, 2006 amounted to \$290,460 compared to \$40,128 for the same period in 2005.

For the quarter ended September 30, 2006, other income was \$7,399 compared to \$139,060 for the same period in 2005. Other income for the nine months ended September 30, 2006 amounted to \$1,304,514 compared to \$658,837 for the same period in 2005. This increase is primarily due to the gain realized on the transfer of the Company's investment in real estate in payment of secured debt of the Company and FPMC as further discussed in the Company's Form 8-K dated May 22, 2006.

Other comprehensive income consists of unrealized holding gains (losses) on marketable investment securities net of income taxes. For the nine months ended September 30, 2006, unrealized holding gains amounted to \$117,334 compared to unrealized holding losses of \$(16,955) for the same period in 2005. For the quarter ended September 30, 2006, unrealized holding gains amounted to \$(78,835) as compared to losses of \$3,440 for the same period in 2005.

Salaries and related expenses decreased to \$46,637 for the quarter ended September 30, 2006 compared to \$1,197,713 for the same period in 2005. For the nine months ended September 30, 2006, \$1,375,855 was incurred in salaries and related expenses compared to \$3,527,057 for the nine months ended September 30, 2005. This decrease is primarily due to the reduction in staff and closing of mortgage operations during the quarter ended June 30, 2006.

Interest expense for the quarter ended September 30, 2006 amounted to \$45,003 compared to \$230,623 for the same time period in 2005. For the nine months ended September 30, 2006, interest expense amounted to \$159,331 compared to \$822,790 for the same period in 2005. The reduction of interest expense is primarily due to the closing of the mortgage operations. The decrease is also due to interest owed being reported on the loan net of the participation sold versus the interest owed being reported on the face value of the loan, as discussed above.

Due to the discontinuance of FPMC's mortgage operations during the quarter ended June 30, 2006, the use by FPMC of certain technology based assets used in the mortgage business significantly changed before the end of its previously estimated useful life. The impairment of value for these technology based assets resulted in an expense in the amount of \$43,940 and \$851,177 for the three months and nine months ended September 30, 2006 respectively.

Other operating expenses for the three months ended September 30, 2006 amounted to \$7,140 compared to \$864,841 for the same period in 2005. For the nine months ended September 30, 2006, other operating expenses were \$1,572,207 compared to \$2,511,121 for the same period in 2005. In the quarter ended September 30, 2006, the Company wrote off the provision for bad debts including any corresponding receivables in the amount of \$148,848. Of this amount, \$128,932 was recorded to provision for bad debts and other operating expense during the 6 months ending June 30, 2006.

The Company is at risk under the agreements described below with private investors and with the Department of Housing and Urban Development ("HUD") for credit losses and cost of foreclosure on default of the borrower.

FPMC entered into a Workout and Forebearance Agreement with CMI, effective July 20, 2005 related to indemnity obligations under loan purchase agreements under which FPMC is obligated to repurchase certain loans from CMI. As of September 30, 2006, the total of amounts payable to CMI, which has been included as a component of the note payable on the accompanying consolidated balance sheet, was \$2,084,032. The amount added to the note payable during the nine months ended September 30, 2006 was \$664,608. This note payable was not increased during the quarter ended September 30, 2006. The sum of the amounts reflected on the accompanying balance sheet under notes payable and under estimated reserve for loan losses that relate to loans sold to CMI is approximately \$3,500,000. This is approximately equal to the amount claimed in the lawsuit by CMI explained in the "Legal Proceedings" below.

FPMC entered into a Stipulation of Settlement Agreement with Washington Mutual effective February 21, 2006, related to indemnity obligations under a Loan Purchase Agreement in which FPMC was obligated to repurchase certain loans from Washington Mutual. The total amount payable to Washington Mutual was \$685,000 as of September 14, 2006. On September 15, 2006, FPMC entered into a Release and Settlement Agreement with Washington Mutual. For consideration of \$65,000 paid by FPMC, Washington Mutual released FPMC of any claims, complaints, liabilities, obligations, promises, agreements, contracts and causes of action, against FPMC. Notes Payable was decreased by \$685,000 and a gain of \$620,000 was recorded in net gain from settlement of note payable.

FPMC has agreements with the Department of Housing and Urban Development ("HUD") under which FPMC is at risk for credit losses and cost of foreclosure on default of the borrower. In January 2005, FPMC entered into a repayment plan with HUD in the amount of \$194,014 for the settlement of various claims. FPMC booked a note payable to HUD for the amount of the obligation and reduced the amount of the loan loss reserve. In March 2005 and February 2006, the amount payable under this plan and the note payable amount were increased by \$45,793 and \$239,419, respectively, so that as of September 30, 2006 the total amount owed under this plan including interest and late fees was \$312,537, payable in installments of \$15,012 per month, including interest. As a result of this plan, the Company has booked charges against its loan loss reserve in the aggregate amount of \$479,406.

The total amount of the settlements with CMI, Washington Mutual and HUD aggregating \$3,426,931 have been charged against the Company's loan loss reserve, the amount of which, at September 30, 2006, was \$2,595,394, as compared to \$2,471,106 at September 30, 2005. During the nine months ended September 30, 2006, the Company increased its provision for loan losses, indemnifications and early default losses by \$1,936,667, resulting in a charge against income in that amount, as compared to a charge of \$2,568,010 for the same period in 2005. For the quarter ended September 30, 2006, FPMC did not increase its provision for loan losses. The Company calculates the loan loss reserve based on historical loan losses, recoverability of losses under the Company's Errors and Omissions ("E&O") insurance policy as well as other factors. For additional information about the Company's claims under its E&O insurance policy see Liquidity and Capital Resources.

FPMC established a general reserve account on or about April 27, 2006 with Countrywide Home Loans, Inc. ("Countrywide") in the amount of \$143,241 to make provision for certain obligations of FPMC that may arise under its loan purchase agreement with Countrywide under which FPMC is obligated to repurchase loans sold to Countrywide. The general reserve account was established with payment from FPMC to Countrywide in the amount of \$143,241. Countrywide and FPMC are in negotiations regarding a Loss Reserve Agreement, which would govern the general reserve account, among other things. The amount in the general reserve account at Countrywide on September 30, 2006 was \$91,091.

During the month of June 2006, and subsequently, FPMC did not make payment to CMI, Washington Mutual or HUD as required by the agreements described above. The amounts payable to CMI and Washington Mutual are zero interest obligations and are reflected on the Company's balance sheet as notes payable. Upon FPMC's default of these two notes during the month of June, FPMC raised the note payable balance to reflect the total of the future scheduled payments. Previously, the Company reflected these notes on a net present value basis. This resulted in an increase to the note payable due CMI in the amount of \$131,583 and an increase to the note payable due Washington Mutual in the amount of \$92,239. These increases were reflected in the previously reported amounts for June 30, 2006.

On August 8, 2006 FPMC received a letter from legal counsel of CMI dated August 7, 2006, declaring FPMC to be in default under its agreements with CMI by failing to make payments due in June, July and August 2006 under the Workout and Forbearance Agreement in the aggregate amount of \$132,500. CMI asserted that all amounts payable by FPMC under the Workout and Forbearance Agreement and the underlying loan agreements have been accelerated and demanded that amounts totaling approximately \$3,500,000 be paid by FPMC, or that acceptable arrangements be made for those amounts to be paid. CMI also asserted related claims against certain affiliates of FPMC, including Citizens Mortgage Corporation ("CMC") and David W. Mann, the Company's chief executive officer. Subsequently, CMI filed suit against FPMC, CMC and Mr. Mann in the United State District court, Eastern District of Missouri, Eastern Division, as described under "Legal Proceedings" in Item 1 of Part II of this report. FPMC filed its original answer to the claims in this suit. CMC has filed a motion to dismiss for lack of personal jurisdiction and for improper venue. Court action is pending. David W. Mann has filed a motion to dismiss for lack of personal jurisdiction. Court action is pending.

Financial Condition

At September 30, 2006, the Company's total assets were \$898,677 compared to \$18,416,008 at September 30, 2005. As a result of the discontinuance of the mortgage operations, the Company has no mortgage loans held for sale as of September 30, 2006. Also, at September 30, 2006, total assets includes only the net amount of the loans originated less the loan participations sold. At September 30, 2005, included in assets were the loans held for sale and included in liabilities was the amount borrowed for these loans. The reduction in total assets is also reflected in cash decreasing by approximately \$.9 million from September 30, 2005 to September 30, 2006, accounts receivable decreasing by approximately \$.25 million from September 30, 2005 to September 30, 2006, and marketable investment securities increasing by approximately \$.29 million from September 30, 2005 to September 30, 2006. Stockholders' deficit of the Company was \$(4,803,703) at September 30, 2006 and the stockholders' deficit was \$(1,133,218) at September 30, 2005.

Liquidity and Capital Resources

Until April 28, 2006, the Company's primary sources of liquidity were proceeds from the sale of mortgage loans, net interest income, fees earned from originating mortgage loans and borrowings under the Company's warehouse credit facilities. The Company's use of cash included the funding of mortgage loans prior to their sale, payment of interest, repayment of amounts borrowed pursuant to warehouse lines of credit, loan repurchase and indemnity obligations, operating and general and administrative expenses and capital expenditures.

FPMC's mortgage warehouse line of credit with Colonial was terminated as of March 31, 2006.

Effective September 26, 2005, FPMC established a temporary loan participation agreement with CSB. At March 31, 2006, approximately \$9.9 million participations were outstanding under this agreement. Also, effective September 26, 2005, FPMC entered into an Amended and Restated Tri-Party Agreement with CSB and Colonial Bank in which Colonial will act as administrator for loan fundings in which CSB has purchased a participation interest from FPMC. By letter received March 29, 2006, FPMC was notified by CSB that CSB would discontinue purchasing participations in the loans originated by FPMC, as a result of which no such loans have been originated by the Company since April 28, 2006. On June 20, 2006, there were no participations outstanding under these agreements.

FPMC has been unsuccessful in obtaining any new source of funding for its mortgage activities. Management does not expect those activities to resume. FPMC had one employee as of September 30, 2006.

On a consolidated basis, cash and cash equivalents were \$171,624 at September 30, 2006. On that date the Company had an accumulated deficit (that is, total liabilities in excess of total assets) of approximately \$5.4 million. Given the cessation of the Company's mortgage origination business, the Company's only significant source of liquidity are the proceeds of its errors and omissions insurance, its Mortgage Bankers Blanket Bond and the sale of its assets related to its mortgage origination business.

The Company has asserted claims against its errors and omissions insurer with respect to errors occurring in the origination of loans, particularly the failure of FPMC's employees to obtain FHA insurance for the loans. The Company and its errors and omission insurer recently agreed to settle these claims for \$482,776, receipt of which is expected in the near future. In addition, the Company submitted a Proof of Loss for a Mortgage Bankers Blanket Bond with respect to loans that had been procured by fraud and/or forgery.

Upon the discontinuance of FPMC's mortgage operations, the assets related to those operations, including certain furniture, fixtures and equipment and leasehold interests in certain branch offices, were transferred to Citizen's Mortgage Corporation ("CMC"), a wholly owned subsidiary of CSB, the president and chief executive officer of which is Mr. Mann and the parent company of which is majority-owned by Mr. Mann and his affiliates. In connection with this transfer, CMC also employed certain of FPMC's former employees and took over the processing of loan applications that had been received by FPMC. The written agreement pursuant to which these assets were transferred has been substantially agreed to but has not as yet been executed by FPMC as seller and CMC as buyer. The purchase price to be paid pursuant to the agreement is expected to be approximately \$334,000, of which approximately \$79,000 is expected to be paid in cash and the balance by the buyer's promissory note. This price is based on an appraisal by an independent expert and the price and terms of the transaction have been negotiated on behalf of FPMC by the independent directors of the Company and legal counsel selected by them. Management of the Company expects this agreement to be executed and closed in the near future.

FPMC is evaluating plans with legal counsel regarding a possible approach to negotiations and discussions concerning settling the claims of creditors against FPMC.

At this time, management does not intend to cause the Company or FPMC to seek protection under the bankruptcy laws. If the process of selling assets is successful and creditors can be satisfied, the Company may retain some residual value that will be preserved for shareholders. It is entirely possible, however, that this process will be unsuccessful, in which case the Company or FPMC may have to seek protection under the bankruptcy laws. If that occurs, the Company's common stock would be likely to have no value.

Forward-looking Information

Certain statements made above and elsewhere in this Form 10-QSB constitute "forward-looking statements," including but not limited to those identified by the words "expect," "believe," "seek to," "intend," "will," "possible," "may" and similar expressions that are attributed to the Company or its management. No forward-looking statements of the Company or its management are guarantees of future outcomes. These statements involve risks and uncertainties, and actual results may differ materially from those in the forward-looking statements as a result of various factors, including but not limited to the value that can be obtained from the sale of the Company's mortgage operations and Company assets and the terms on which creditors will agree to be repaid.

Item 3. Controls and Procedures

The Company evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2006. 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 the evaluation, Mr. Mann, the Chief Executive Officer and the Chief Financial Officer, concluded that the design and operation of the Company's disclosure controls and procedures are effective in providing assurance that information required to be disclosed by the Company in the reports that it files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to management as appropriate to allow timely decisions regarding disclosure. There have been no changes during the fiscal quarter ended September 30, 2006 in the Company's internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

On August 28, 2006, CitiMortgage, Inc. ("CMI") filed suit in the United States District Court for the Eastern District of Missouri against FPMC, David W. Mann and Citizens Mortgage Corporation ("CMC"). CMC is a subsidiary of Citizen's State Bank, the president and chief executive officer of which is Mr. Mann and the parent company of which is majority-owned by Mr. Mann and his affiliates. This litigation results from defaults by FPMC in the repayment to CMI of amounts required to be paid by FPMC under its July 20, 2006 Workout and Forbearance Agreement with CMI and under the underlying loan agreements, as described under "Results of Operations" in Item 2 of Part I of this report. Amounts claimed by CMI to be payable under these agreements total approximately \$3,500,000. CMI also makes claims in this litigation against FPMC, Mr. Mann and CMC based on allegations that FPMC made transfers to CMC of assets related to its mortgage operations without receiving reasonably equivalent value in exchange. The amount of these claims is not quantified. In answer to this suit, FPMC has filed a general denial. CMS has moved to dismiss the suit for lack of personal jurisdiction and improper venue and Mr. Mann has moved to dismiss the suit for lack of personal jurisdiction.

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, believes that liability resulting from the litigation, if any, will not have a material effect on the financial position of the Company.

Item 6. Exhibits

Exhibit 3.1 Restated Articles of Incorporation of First Financial Corporation (incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002).

Exhibit 3.2 Amended and Restated Bylaws of First Financial Corporation (incorporated by reference to the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002).

Exhibit 31.1 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

Exhibit 32.1 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

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 20, 2006

/s/ David W. Mann

David W. Mann

President

Duly Authorized Officer and

Principal Financial Officer

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