1ST INDEPENDENCE FINANCIAL GROUP, INC.
Form 10KSB
March 30, 2005

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

(Mark One)

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

- or -

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

For the transition period from October 1, 2004 to December 31, 2004

Commission Number: 0-26570

1ST INDEPENDENCE FINANCIAL GROUP, INC.

(Exact name of Registrant as specified in its Charter)

Delaware	**61-1284899**
(State or other jurisdiction	**(I.R.S. Employer or Organization**

of incorporation)	**Identification No.)**
104 South Chiles Street, Harrodsburg, Kentucky **(Address of principal executive offices)**	**40330-1620** **Zip Code**

Registrant s telephone number, including area code:

(859) 734-5452

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, par value $.10 per share

(Title of Class)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for 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 x NO ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-B is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. x

Registrant s revenues for the three months ended December 31, 2004: $4.3 million.

The aggregate market value of the voting and non-voting stock held by non-affiliates of the Registrant, based on the closing price of the Registrant s Common Stock as quoted on the NASDAQ National Market on March 1, 2005, was approximately $30.9 million.

As of March 1, 2005 there were issued and outstanding 1,916,368 shares of the Registrant s Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE:

The information required by Part III of this Report on Form 10-KSB, to the extent not set forth herein, is incorporated herein by reference to the Registrant s definitive proxy statement to be filed in connection with the annual meeting of shareholders to be held on May 19, 2005.

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISK FACTORS

This filing, like many written and oral communications presented by the Registrant (as defined herein) and its authorized officials, may contain certain forward-looking statements regarding the Company s prospective performance and strategies within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. The Registrant intends such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and is including this statement for purposes of said safe harbor provisions.

Forward-looking statements, which are based on certain assumptions and describe future plans, strategies, and expectations of the Registrant, are generally identified by use of the words plan, believe, expect, intend, anticipate, estimate, project, or similar expressions. The Registra to predict results or the actual effects of its plans or strategies, including its recent merger with Independence Bancorp, is inherently uncertain. Accordingly, actual results may differ materially from anticipated results.

The following factors, among others, could cause the actual results of the Independence Bancorp merger to differ materially from the expectations stated in this filing: the ability to successfully integrate the companies following the merger, including the retention of key personnel; the ability to fully realize the expected cost savings and revenues; and the ability to realize the expected cost savings and revenues on a timely basis.

Additional factors that could have a material adverse effect on the operations of the Registrant include, but are not limited to: changes in general economic conditions; interest rates, deposit flows, loan demand, real estate values, competition and demand for financial services and loan, deposit, and investment products in the Registrant s local markets; changes in the quality of composition of the loan or investment portfolios; changes in accounting principles, policies, or guidelines; changes in legislation and regulation; changes in the monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; war or terrorist activities; and other economic, competitive, governmental, regulatory, geopolitical, and technological factors affecting the Registrant s operations, pricing, and services.

Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this filing. Except as required by applicable law or regulation, the Registrant undertakes no obligation to update these forward-looking statements to reflect events or circumstances that occur after the date on which such statements were made.

PART I

Item 1. Description of Business

General

1st Independence Financial Group, Inc. (FIFG) was organized as a Delaware corporation in June 1995, and was formerly known as Harrodsburg First Financial Bancorp, Inc. On July 9, 2004, it changed its name to 1st Independence Financial Group, Inc. (the Company , or collectively with its subsidiaries, the Registrant) and acquired the remaining 77.5% interest of Independence Bancorp, New Albany, Indiana (Independence) in a purchase transaction calling for the exchange of one share of its common stock for each share of Independence common stock held by Independence shareholders (the Merger). The Company had initially acquired 22.5% of Independence on December 31, 2002. Upon completion of

the Merger, the Company issued approximately 696,000 shares to the Independence shareholders and exchanged approximately 60,000 stock options held by directors, executive officers, and employees of Independence. Additionally, as previously disclosed, the Company changed is fiscal year-end from September 30 to December 31.

In connection with the Merger, the Company s, wholly owned subsidiary, First Financial Bank and Independence s wholly owned subsidiary, 1st Independence Bank, merged their operations (the Bank Merger). The Bank Merger occurred at the same time as the Merger and the resulting institution became a Kentucky state-chartered bank known as 1st Independence Bank, Inc. (the Bank).

The Bank currently serves its customers through a network of seven branches located in Harrodsburg, Lawrenceburg and Louisville, Kentucky and New Albany, Jeffersonville, Marengo and Clarksville, Indiana. The Bank also operates a mortgage division, 1st Independence Mortgage Group, which originates one-to-four family residential mortgage loans. 1st Independence Mortgage Group operates throughout the Bank s branch network and has one stand alone location in Louisville, Kentucky. The Bank also offers limited trust services. On November 1, 2004, the Bank formed a title insurance company, Foundation Title Company, LLC, located in Jeffersonville, Indiana.

The Registrant provides commercial and retail banking services, with an emphasis on commercial real estate loans, one-to-four family residential mortgage loans via 1st Independence Mortgage Group, home equity loans and lines of credit and consumer loans as well as certificates of deposit, checking accounts, money-market accounts and savings accounts within its market area. At December 31, 2004, the Registrant had total assets, deposits and equity of $337.2 million, $223.3 million, and $37.7 million, respectively. The Registrant s business is conducted principally through the Bank. Unless otherwise indicated, all references to the Company refer collectively to the Company and the Bank and its subsidiaries.

Recent Developments

In July 2001 the Company purchased a 55.8% interest in Citizens Financial Bank, Inc., Glasgow, Kentucky (Citizens). Subsequently, the Company determined to sell its interest in Citizens, which reflects the Company s revised strategic plan to exit the south central Kentucky market and to focus on the growing markets of southern Indiana, central Kentucky, and greater Louisville, Kentucky. On October 22, 2004, the Company entered into a stock purchase agreement with Porter Bancorp, Inc., Shepherdsville, Kentucky (Porter Bancorp) to sell to Porter Bancorp its 55.8% interest in Citizens for $2,300,000, or $16.33 per share. Subsequent to December 31, 2004, the agreement was amended to provide that the Company would pay approximately $50,000 of Porter Bancorp s attorneys fees. In accordance with Statement of Financial Accounting Standard (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-lived Assets , at September 30, 2004 the Company reclassified its investment in Citizens as an available-for-sale asset and recognized an after tax loss of approximately $239,000. See Note 4 to the Registrant s financial statements, presented herein, for a more detailed discussion. Additionally, the financial tables also presented herein, have been revised to reflect the discontinued operations of Citizens.

Concurrent with the signing of the stock purchase agreement, the Bank entered into a real estate contract with Porter Bancorp s affiliate, Ascencia Bank, to purchase property and a building, located at 8620 Biggin Hill Lane, Louisville, Kentucky, that was previously used as an operations center and retail branch. Under the terms of the real estate contract, the Bank agreed to pay $2,300,000 for the property. The Bank plans to move its finance and accounting, loan and deposit operations, and mortgage group into the building in April 2005. The Bank anticipates the costs of readying the property for its intended use to be approximately $170,000.

The stock purchase transaction and the real estate transaction discussed above consummated on January 28, 2005.

Market Area and Competition

The competition for deposit products comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, and multi-state regional banks in the Registrant s market area of Anderson, Jefferson, and Mercer Counties, Kentucky and Floyd, Clark and Crawford Counties, Indiana. Deposit competition also includes a number of insurance products sold by local agents and investment products such as mutual funds and other securities sold by local and regional brokers. Loan competition varies depending upon market conditions and comes from other insured financial institutions such as commercial banks, thrift institutions, credit unions, multi-state regional banks, and mortgage bankers.

Analysis of Loan Portfolio. The following table sets forth information concerning the composition of the Registrant s loan portfolio in dollar amounts and in percentages of the total loan portfolio as of the dates indicated. Loan balances related to the discontinued operations of Citizens for 2001-2003 have been eliminated.

	December 31,				September 30,					
	2004		2003		2002		2001		2000	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars In Thousands)									
Real Estate:										
Commercial	$ 35,795	15.11%	$ 13,166	15.54%	$ 13,040	13.94%	$ 11,984	11.34%	$ 11,541	11.03%
Residential	126,097	53.25	61,869	73.01	71,235	76.18	81,584	77.18	82,767	79.12
Construction	33,676	14.22	3,037	3.58	3,803	4.07	7,160	6.77	6,319	6.04
Commercial	21,061	8.89	3,381	3.99	2,195	2.35	1,166	1.10	337	0.32
Consumer:										
Home equity	16,485	6.96	1,963	2.31	1,630	1.74	1,873	1.77	1,775	1.70
Other	3,706	1.57	1,327	1.57	1,607	1.72	1,941	1.84	1,872	1.79
Total loans	236,820	100.00%	84,743	100.00%	93,510	100.00%	105,708	100.00%	104,611	100.00%
Less:										
Loans in process							2,687		2,947	
Deferred loan origination fees and costs, net	623		488		439		438		411	
Allowance for loan losses	2,549		391		390		407		372	
Loans, net	$ 233,648		$ 83,864		$ 92,681		$ 102,176		$ 100,881	
Loans held for sale	$ 2,344		$		$		$		$	

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Loan Maturity Tables

The following table sets forth the maturity of the Registrant s loan portfolio at December 31, 2004. The table does not include prepayments or scheduled principal repayments. Adjustable-rate mortgage loans are shown as maturing based on contractual maturities.

	Due within 1 year	Due after 1 through 5 years	Due after 5 years	Total
	(In Thousands)			
Real Estate:				
Commercial	$ 6,922	$ 17,156	$ 11,717	$ 35,795
Residential	17,226	14,197	94,674	126,097
Construction	18,757	8,818	6,101	33,676
Commercial	12,998	4,934	3,129	21,061
Consumer	1,454	16,422	2,315	20,191
Total	$ 57,357	$ 61,527	$ 117,936	$ 236,820

The following table sets forth as of December 31, 2004 the dollar amount of all loans that are due after December 31, 2005 and have either fixed rates of interest or floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
	(In Thousands)		
Real Estate:			
Commercial	$ 11,743	$ 17,130	$ 28,873
Residential	31,440	77,431	108,871
Construction	6,277	8,642	14,919
Commercial	4,483	3,580	8,063
Consumer	2,268	16,469	18,737
Total	$ 56,211	$ 123,252	$ 179,463

Commercial Real Estate Loans. Since the completion of the Merger, the Registrant has changed the composition of its loan portfolio to emphasize commercial real estate loans in order to enhance yields on its assets. The commercial real estate loans originated are generally made to individuals, small businesses and partnerships located in the Registrant s primary market area. Such loans are generally secured by first mortgages on apartment buildings, office buildings, churches and other properties. Adjustable-rate loans for this type of lending have a margin that is 50 to 150 basis points higher than the margin added to single-family owner-occupied property loan. Commercial real estate loans are adjustable-rate loans with terms of 30 years or less and loan-to-value ratios typically not exceeding 80%. At December 31, 2004, commercial real estate loans totaled approximately $35.8 million or 15.11% of the total loan portfolio.

Commercial real estate lending entails significant additional risks as compared to one- to four-family residential lending. For example, such loans typically involve large loans to single borrowers or related borrowers, the payment experience on such loans is typically dependent on the successful operation of the project, and these risks can be significantly affected by the supply and demand conditions in the market for commercial property.

Loans secured by commercial real estate generally involve a greater degree of risk than residential mortgage loans and carry larger loan balances. This increased credit risk is a result of several factors, including the concentration of principal in a limited number of loans and borrowers, the effects of general economic conditions on income producing properties, and the increased difficulty of evaluating and monitoring these types of loans. Furthermore, the repayment of loans secured by commercial real estate is typically dependent upon the successful operation of the related real estate project. If the cash flow from the project is reduced, the borrower s ability to repay the loan may be impaired. To minimize these risks, the Registrant generally limits loans of this type to its market area and to borrowers with which it has substantial experience and expertise in the commercial real estate market. The Registrant s underwriting procedures require verification of the borrower s credit history, income, financial statements, banking relationships, credit references, and income projections for the property. It is their current practice to obtain personal guarantees from all principals obtaining this type of loan. The Registrant also obtains appraisals on each property. All appraisals on commercial and multi-family real estate are reviewed by Registrant s management.

Included in the commercial real estate loan category are agricultural loans. Since the completion of the Merger, the Registrant has de-emphasized the origination of agriculture loans. At December 31, 2004, total agricultural loans totaled $2.5 million, or 1.05% of the Registrant s loan portfolio.

Residential Loans. The Registrant s residential loans consist of one- to four-family residential mortgage loans that are secured by property located in its primary market area. The Registrant generally originates one- to four-family residential mortgage loans without private mortgage insurance in amounts up to 85% of the lesser of the appraised value or selling price of the mortgaged property. Loans in excess of 89.9% of the value of the mortgaged property typically carry higher rates commensurate with the higher risk associated with this type of loan. At December 31, 2004, one-to four-family totaled approximately $126.1 million, or 53.25% of the total loan portfolio.

The Registrant offers three types of residential adjustable rate mortgage loans, all of which use the index value of the Weekly Average Yield on United States Treasury Securities Adjusted to a Constant Maturity of One Year plus a set margin added to it. The interest rates on these loans have an initial adjustment period of between one and five years, and generally adjust annually thereafter, with a maximum adjustment of 2% per year and a maximum increase of 5% over the life of the loan. The index margin on a non owner-occupied one- to four-family property loan is generally 50 basis points higher than on an owner-occupied property loan. The Registrant s adjustable-rate one-to- four family and multi-family mortgage loans are for terms of up to 30 years, amortized on a monthly basis, with principal and interest due each month. Borrowers may refinance or prepay loans at their option without penalty. All fixed rate one-to-four family loans with a term of ten to thirty years are originated and sold on the secondary market through 1st Independence Mortgage Group. At December 31, 2004, loans held for sale totaled approximately $2.3 million.

Loan originations are generally obtained from existing and walk-in customers, members of the local community, and referrals from realtors, builders, depositors and borrowers within the Registrant s market area. Mortgage loans originated and held by the Registrant in its portfolio generally include due-on-sale clauses which gives it the contractual right to deem the loan immediately due and payable in the event that the borrower sells or otherwise transfers an interest in the property to a third party.

During periods of rising interest rates, the risk of default on adjustable-rate loans may increase due to increases in interest costs to borrowers. Further, adjustable-rate loans that provide for initial rates of interest below the fully indexed rates may be subject to increased risk of delinquency or default as the higher, fully indexed rate of interest subsequently replaces the lower, initial rate.

Construction and Land Development Loans. The Registrant engages in construction lending involving loans to qualified borrowers for construction of one- to four-family dwellings, multi-family residential units, commercial buildings and churches, and single family subdivision land development loans with the intent of such loans converting to permanent financing upon completion of construction. All construction and development loans are secured by a first lien on the property under construction. Loan proceeds are disbursed in increments as construction progresses and as inspections warrant. At December 31, 2004, construction loans totaled approximately $33.7 million, or 14.22%, of the Registrant s total loan portfolio.

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Construction/permanent loans generally have adjustable or fixed interest rates and are underwritten in accordance with the same terms and requirements as permanent mortgages, except the loans generally provide for disbursement in stages during a construction period of up to twelve months, during which the borrower is not required to make monthly payments. If construction improvements are not completed at the end of six months, accrued interest must be paid to date. Accrued interest must be paid at completion of construction to the first day of the following month, and monthly payments start the first day of the following month if the loan is converted to permanent financing. Borrowers must satisfy all credit requirements that would apply to permanent mortgage loan financing for the subject property and must execute a construction loan agreement.

Construction financing generally is considered to involve a higher degree of risk of loss than long term financing on improved, occupied real estate. Risk of loss on a construction loan is dependent largely upon the accuracy of the initial estimate of the property s value at completion of construction or development and the estimated cost (including interest) of construction. During the construction phase, a number of factors could result in delays and cost overruns. If the estimate of construction cost proves to be inaccurate, the Registrant may be required to advance funds beyond the amount originally committed to permit completion of the development. The Registrant has sought to minimize this risk by requiring precise construction cost estimates, specifications, and drawing plans from qualified borrowers in their market area along with tighter underwriting guidelines relating to borrower cash flow and net worth.

Commercial Loans. The Registrant originates fixed-rate and adjustable-rate commercial loans secured by commercial properties. These loans are originated with maximum loan-to-value ratios of 80% of the value of the respective property. At December 31, 2004, commercial loans totaled approximately $21.1 million, or 8.89%, of the total loan portfolio.

Loans secured by commercial properties generally have larger balances and involve a greater degree of risk than one- to four-family residential mortgage loans. Of primary concern in commercial lending are the borrower s creditworthiness and the feasibility and cash flow potential of the project. Payments on loans secured by income properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to a greater extent than residential real estate loans to adverse conditions in the real estate market or the economy. To monitor cash flows on income properties, the Registrant requires borrowers and loan guarantors, if any, to provide annual financial statements on commercial loans. In reaching a decision on whether to make a commercial loan, the Registrant considers the net operating income of the property, the borrower s expertise, credit history and profitability and the value of the underlying property. The Registrant generally requires an environmental survey for all commercial loans over $500,000.

Consumer Lending. The Registrant originates consumer loans on either a secured or unsecured basis. The Registrant generally makes certificate of deposit loans for terms of up to the terms of the certificate of deposit collateralizing the loan and up to the face amount of the certificate. The interest rate charged on these loans is up to 2% higher than the rate paid on the certificate, and interest is changed on a quarterly basis. These loans are payable on demand and the account must be assigned to the Registrant as collateral for the loan. At December 31, 2004, consumer loans totaled approximately $20.2 million, or 8.53%, of the total loan portfolio.

Consumer loans may entail greater risk than residential loans, particularly in the case of consumer loans that are unsecured or secured by assets that depreciate rapidly. Repossessed collateral for a defaulted consumer loan may not be sufficient for repayment of the outstanding loan, and the remaining deficiency may not be collectible.

Loan Approval Authority and Underwriting. The Registrant has established various lending limits for its officers and maintains a loan committee that consists of N. William White, President and Chief Executive Officer of the Bank, Alan D. Shepard, Executive Vice President of the Bank and seven other senior officers of the Bank. Any two officers may join together to approve loans, but only to the limit of the higher authority of the two officers. The loan committee approves loans that exceed the limits

established for individual officers and may approve secured loans of up to $1,500,000 and unsecured loans up to $10,000. In January 2005, the loan policy was amended to provide for two classes of secured loans. Class I loans are those secured by investment grade securities, securities listed on the major stock exchanges, deposit accounts, life insurance cash surrender value, and real estate mortgages meeting certain loan to value ratios. Class II loans consist of all other asset-based lending. The loan committee may approve Class I and Class II loans of $3,000,000 and $2,000,000, respectively. At the same time, approval limits for unsecured loans were increased to $25,000. The Bank s directors loan committee, which consists of four outside Bank directors, must approve all loans that exceed the lending limits of the loan committee.

For all loans originated by the Registrant, upon receipt of a completed loan application from a prospective borrower, a credit report is generally ordered, income and certain other information is verified and, if necessary, additional financial information is requested. An appraisal of the real estate intended to be used as security for the proposed loan is obtained. All appraisals are reviewed by the Bank s loan officers designated by the Bank s Board of Directors. An independent appraiser designated and approved by the Bank s Board of Directors is utilized for all real estate mortgage loans. For construction/permanent loans, the funds advanced during the construction phase are disbursed based upon various stages of completion in accordance with the results of inspection reports that are based upon physical inspection of the construction by an independent contractor hired by the Bank or in some cases by an officer of the Bank. For real estate loans, the Bank requires either title insurance or a title opinion. Borrowers must also obtain fire and casualty, hazard or flood insurance (for loans on property located in a flood zone, flood insurance is required) prior to the closing of the loan.

Loan Commitments. The Registrant issues written commitments to prospective borrowers on all approved commercial real estate loans in excess of $100,000. Generally, the commitment requires acceptance within 20 days of the date of issuance. At December 31, 2004, the Registrant had approximately $56.0 million of commitments to cover originations and unused lines of credit.

Nonperforming and Problem Assets

Loan Delinquencies. The Registrant s collection procedures provide that when a loan is 10 days past due, a notice of nonpayment is sent. Delinquent notices are sent if the loan becomes delinquent for more than 30 days and generally the borrower will receive a letter or be personally contacted by an officer of the bank. If payment is still delinquent after 60 days, the customer will again receive a letter and/or telephone call and may receive a visit from an officer representative of the Bank. If the delinquency continues, similar subsequent efforts are made to eliminate the delinquency. If the loan continues in a delinquent status for 90 days past due and no repayment plan is in effect, management will generally initiate legal proceedings.

Loans are reviewed on a monthly basis by management and are generally placed on a non-accrual status when the loan becomes more than 90 days delinquent and, in the opinion of management, the collection of additional interest is doubtful. Interest accrued and unpaid at the time a loan is placed on non- accrual status is charged against interest income. Subsequent interest payments are applied to the outstanding principal balance.

Nonperforming Assets. The following table sets forth information regarding non-accrual loans, real estate owned and certain other repossessed assets and loans. Nonperforming asset balances related to the discontinued operations of Citizens for 2001-2003 have been eliminated. Additionally, as of the dates indicated, the Registrant had no loans categorized as troubled debt restructurings within the meaning of SFAS 15 and impaired loans within the meaning of meaning of SFAS 114, as amended by SFAS 118, were approximately $565,000 at December 31, 2004.

	December 31,		September 30,		
	2004	2003	2002	2001	2000
	(Dollars in Thousands)				
Non-accrual loans	$ 893	$	$	$	$
Accruing loans past due 90 days or more	332	472	334	222	517
Total nonperforming loans	$ 1,225	472	334	222	517
Real estate owned			233		