

# LITCHFIELD FINANCIAL CORP /MA

## FORM 10-Q (Quarterly Report)

Filed 11/13/96 for the Period Ending 09/30/96

Address	430 MAIN STREET WILLIAMSTOWN, MA 01267
Telephone	4134581000
CIK	0000882515
SIC Code	6162 - Mortgage Bankers and Loan Correspondents
Fiscal Year	12/31

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Address	430 MAIN STREET WILLIAMSTOWN, Massachusetts 01267
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Fiscal Year	12/31

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

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

For the quarterly period ended SEPTEMBER 30, 1996

*Commission File Number: 0-19822*

## LITCHFIELD FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

MASSACHUSETTS

04-3023928

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer Identification No.)

**789 MAIN ROAD, STAMFORD, VT 05352**

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (802) 694-1200

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(Former name, former address and former fiscal year,  
if changed since last report)

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  No

As of November 12, 1996, 5,444,399 shares of common stock of Litchfield Financial Corporation were outstanding.

**LITCHFIELD FINANCIAL CORPORATION**  
**FORM 10-Q**

**QUARTER ENDED SEPTEMBER 30, 1996**

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PART I - FINANCIAL STATEMENTS

Item 1. Financial Statements

LITCHFIELD FINANCIAL CORPORATION

Consolidated Balance Sheets  
(in 000's except share amounts)

	September 30, 1996	December 31, 1995
	(unaudited)	
ASSETS		
Cash and cash equivalents	\$ 10,510	\$ 18,508
Restricted cash and cash equivalents	18,042	16,345
Loans held for sale, net of allowance for loan losses of \$580 in 1996 and \$1,100 in 1995	8,699	14,380
Loans held for investment, net of allowance for loan losses of \$938 in 1996 and \$413 in 1995	63,889	33,613
Subordinated pass-through certificates held to maturity, net of allowance for loan losses of \$1,500 in 1996 and \$1,270 in 1995	17,648	13,468
Excess servicing asset	11,810	10,058
Deferred debt issuance costs	1,917	2,211
Other assets	4,743	4,808
	-----	-----
Total assets	\$137,258	\$113,391
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Lines of credit	\$ 21,600	\$ ---
Term note payable	7,866	9,836
Accounts payable and accrued liabilities	2,907	4,442
Dealer/developer reserves	9,951	9,644
Allowance for loans sold	1,300	932
Deferred income taxes	4,780	3,740
	-----	-----
	48,404	28,594
	-----	-----
10% Notes due 2002	12,888	12,888
8 7/8 % Notes due 2003	15,930	16,113
10% Notes 2004	18,280	18,400
	-----	-----
	47,098	47,401
	=====	=====
Stockholders' equity:		
Preferred stock, \$.01 par value; authorized 1,000,000 shares, none issued and outstanding	---	---
Common stock, \$.01 par value; authorized 8,000,000 shares, 5,493,389 shares issued and 5,444,399 shares outstanding in 1996; 5,223,715 shares issued and 5,174,715 shares outstanding in 1995	55	52
Additional paid in capital	35,226	31,873
Retained earnings	7,069	6,065
Less 48,990 common shares held in treasury, at cost,	(594)	(594)
Total stockholders' equity	41,756	37,396
	-----	-----
Total liabilities and stockholders' equity	\$137,258	\$113,391
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

FORM 10-Q

**LITCHFIELD FINANCIAL CORPORATION**  
**Consolidated Statements of Income**  
(in 000's except share and per share amounts)

**Unaudited**

Three Months Ended September 30,

	1996	1995
Revenues:		
Interest income	\$3,747	\$2,814
Gain on sale of loans	2,811	2,149
Loan origination and fee income	315	227
Servicing income	263	274
	-----	-----
	7,136	5,464
	-----	-----
Expenses:		
Interest expense	1,843	1,639
Salaries and employee benefits	806	640
Other operating expenses	898	663
Provision for loan losses	420	195
	-----	-----
	3,967	3,137
	-----	-----
Income before income taxes	3,169	2,327
Provision for income taxes	1,223	873
	-----	-----
Net income	\$1,946	\$1,454
	=====	=====
Primary and fully-diluted net income per common share	\$ .34	\$ .33
	=====	=====
Weighted average number of shares	5,720,924	4,412,366

See accompanying notes to unaudited consolidated financial statements.

FORM 10-Q

LITCHFIELD FINANCIAL CORPORATION  
**Consolidated Statements of Income**  
(in 000's except share and per share amounts)

Unaudited

	Nine Months Ended September 30,	
	1996	1995
Revenues:		
Interest income	\$10,260	\$7,786
Gain on sale of loans	6,165	3,920
Loan origination and fee income	904	550
Servicing income	783	532
	-----	-----
	18,112	12,788
	-----	-----
Expenses:		
Interest expense	5,140	4,593
Salaries and employee benefits	2,372	1,616
Other operating expenses	2,219	1,580
Provision for loan losses	1,374	518
	-----	-----
	11,105	8,307
	-----	-----
Income before income taxes	7,007	4,481
Provision for income taxes	2,699	1,682
	-----	-----
Net income	\$4,308	\$2,799
	=====	=====
Primary and fully-diluted net income per common share	\$ .75	\$ .64
	=====	=====
Weighted average number of shares	5,715,391	4,398,797

See accompanying notes to unaudited consolidated financial statements.

**FORM 10-Q**

**LITCHFIELD FINANCIAL CORPORATION**  
**Consolidated Statements of Stockholders' Equity**  
(in 000's)

**Unaudited**

	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Total
	-----	-----	-----	-----	-----
Balance, December 31, 1995	\$52	\$31,873	\$ 6,065	\$(594)	\$37,396
Issuance of 10,560 shares of common stock (including reissuance of 10 shares held in treasury)	---	52	---	---	52
5% Stock dividend	3	3,301	(3,304)	---	---
Net income	---	---	4,308	---	4,308
Balance, September 30, 1996	\$55	\$35,226	\$7,069	\$(594)	\$41,756
	===	=====	=====	=====	=====

See accompanying notes to unaudited consolidated financial statements.



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LITCHFIELD FINANCIAL CORPORATION

Consolidated Statements of Cash Flows  
(in 000's)  
Unaudited

Nine Months Ended September 30,

	1996	1995
	-----	-----
Cash flows from operating activities:		
Net income	\$4,308	\$2,799
Adjustments to reconcile net income to net cash used in operating activities:		
Gain on sale of loans	(6,165)	(3,920)
Amortization and depreciation	462	357
Provision for loan losses	1,374	518
Deferred income taxes	1,040	592
Net changes in operating assets and liabilities:		
Restricted cash and cash equivalents	(1,697)	(4,686)
Loans held for sale	5,681	(6,812)
Excess servicing asset	1,841	(800)
Dealer/developer reserves	307	2,976
Net change in other assets and liabilities	(4,263)	(969)
	-----	-----
Net cash provided by (used in) operating activities	2,888	(9,945)
	-----	-----
Cash flows from investing activities:		
Purchase of investments held to maturity	---	(5,595)
Redemption of investments held to maturity	101	9,196
Net originations and principal payments on loans held for investment	(30,276)	(19,554)
Repayments of loans held for investments	---	11,364
Capital expenditures and other assets	(90)	(2,107)
	-----	-----
Net cash used in investing activities	(30,265)	(6,696)
	=====	=====
Cash flows from financing activities:		
Net borrowings (repayments) on lines of credit	21,600	(5,823)
Retirement of long-term Notes	(303)	(875)
Proceeds from issuance of long-term Notes	---	18,400
Proceeds from term note	---	12,500
Payments on term note	(1,970)	(1,981)
Net proceeds from issuance of common stock	52	215
	-----	-----
Net cash provided by financing activities	19,379	22,436
	-----	-----
Net increase (decrease) in cash and cash equivalents	(7,998)	5,795
Cash and cash equivalents, beginning of period	18,508	5,534
	-----	-----
Cash and cash equivalents, end of period	\$10,510	\$11,329
	=====	=====
Supplemental Schedule of Noncash Financing and Investing Activities:		
Exchange of mortgage loans for subordinated pass-through certificates	\$3,540	\$8,842
	=====	=====
Exchange of mortgage loans for investments held to maturity	\$ ---	\$ 358
	=====	=====
Transfers from loans to real estate acquired through foreclosure	\$ 498	\$ 824
	=====	=====
Supplemental Cash Flow Information:		
Interest paid	\$4,806	\$4,315
	=====	=====
Income taxes paid	\$1,154	\$1,090
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

LITCHFIELD FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**A. Basis of Presentation**

The accompanying unaudited consolidated interim financial statements as of September 30, 1996 and for the three and nine month periods ended September 30, 1996 and 1995 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 1996, are not necessarily indicative of the results expected for the year ended December 31, 1996. For further information, refer to the consolidated financial statements and footnotes thereto included in Litchfield Financial Corporation's annual report on Form 10-K for the year ended December 31, 1995.

In May, 1995, the Financial Accounting Standards Board issued Accounting Standard No. 122, "Accounting for Mortgage Servicing Rights; an Amendment of FASB Statement No. 65." The provisions of this standard are effective for fiscal years beginning after December 15, 1995. Adoption of this standard as of January 1, 1996 did not have a significant impact on the Company.

In October 1995, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 "Accounting for Stock-Based Compensation." The Company intends to continue to account for its stock compensation arrangements under the provisions of APB No. 25 "Accounting for Stock Issued to Employees" with adoption of the new standard for the fiscal year ending December 31, 1996.

In June 1996, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 125 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." In general, the provisions of this standard are effective for financial statements for transfers and servicing of financial assets and extinguishments of liabilities occurring after December 31, 1996, and shall be applied prospectively. Due to the recent issuance of the standard, the Company has not fully evaluated the impact that the adoption of the standard is expected to have on its financial statements. However, our preliminary evaluation is that adoption of the standard is not expected to have a significant impact on the Company.

On July 23, 1996, the Board of Directors declared a five percent stock dividend on the Company's Common Stock payable August 9, 1996 to stockholders of record on July 23, 1996. Accordingly, all per share amounts have been restated to reflect the stock dividend.

**B. Sale of Notes**

Since its inception, the Company has sold \$239,945,000 of loans at face value (\$194,515,000 through December 31, 1995). The principal amount remaining

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**LITCHFIELD FINANCIAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)**

on the loans sold was \$125,793,000 at September 30, 1996 and \$111,117,000 at December 31, 1995. The Company guarantees, through replacement or repayment, loans in default up to a specified percentage of loans sold. Dealer/developer guaranteed loans are secured by repurchase or replacement guarantees in addition to, in most instances, dealer/developer reserves.

The Company's undiscounted exposure to loss on loans sold in the event of nonperformance by the consumer, default by the dealer/developer on its guarantee, and the determination that the collateral is of no value was \$8,839,000 at September 30, 1996 (\$10,259,000 at December 31, 1995). The Company repurchased \$264,000 and \$110,000 of loans under the recourse provisions of loan sales during the three months ended September 30, 1996 and 1995, respectively. Loans repurchased during the nine months ended September 30, 1996 and 1995 were \$778,000 and \$329,000, respectively, and \$448,000 during the year ended December 31, 1995. In addition, when the Company sells loans through securitization programs, the Company commits either to replace or repurchase any loans that do not conform to the requirements thereof in the operative loan sale documents. Also, in connection with certain securitization programs, \$17,734,000 of cash and cash equivalents are restricted as credit enhancements at September 30, 1996.

The Company's Serviced Portfolio is geographically diversified with collateral and consumers located in 41 and 50 states, respectively. At September 30, 1996, 14.1% and 9.9% of the collateral by property balance were located in Texas and California, respectively, and 13.4%, 10.2% and 9.9% of the borrowers by collateral location were located in Texas, Florida and New York, respectively.

**C. Debt**

At September 30, 1996, the Company had a secured warehouse line of credit of \$20,000,000 with an over line of \$5,000,000 from the Bank of Boston. The Company can elect to borrow all or part of the outstanding balance on the line of credit and the over line at either the Bank's prime interest rate or the Eurodollar rate plus 2%. Outstanding borrowings under the line of credit and the over line at September 30, 1996 were \$21,600,000. On October 2, 1996, the warehouse line of credit was amended to include a \$10,000,000 syndication with Fleet Bank - NH. The borrowings on the over line were incorporated into the amended facility and the over line expired. Bank of Boston is the agent bank for the facility. The warehouse line of credit matures in April 1997, with renewal at the lender's discretion. At December 31, 1995 the secured warehouse line of credit was \$15,000,000 at the Bank's prime interest rate plus 1%. There were no outstanding borrowings at December 31, 1995. On July 23, 1996, the Company entered into an additional secured line of credit of \$5,000,000 with another financial institution at that institution's prime rate of interest plus 1.25%. This warehouse line of credit matures in July 1997. There were no outstanding borrowings on this line of credit at September 30, 1996. The lines of credit are secured by consumer receivables and other secured loans. On September 13, 1996, the Company entered into a \$15,000,000 revolving line of credit facility with the Bank of Scotland. The facility is secured by certain subordinated pass-through certificates and excess servicing assets and matures in September 1999. Interest is payable quarterly in arrears at the Bank's prime interest rate plus 1%. There were no outstanding borrowings under this facility at September 30, 1996. The Company is not required to maintain compensating balances or forward sales commitments under the terms of these lines of credit.

LITCHFIELD FINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

The Company also has a revolving line of credit as part of an asset backed commercial paper facility with Holland Limited Securitization, Inc. ("HLS") a multi-seller commercial paper issuer sponsored by Internationale Nederlanden (U.S.) Capital Markets, Inc. ("ING"). In October 1996, the Company amended the facility to increase the facility to \$100 million, subject to certain terms and conditions, reduce certain credit enhancement requirements and expand certain loan eligibility criteria. The facility expires in June 1998.

In connection with the HLS facility, the Company formed a wholly owned subsidiary, Litchfield Mortgage Securities Corporation 1994 ("LMSC"), to purchase loans from the Company. LMSC either pledges the loans on a revolving line of credit with HLS or sells the loans to HLS. HLS issues commercial paper or other indebtedness to fund the purchase or pledge of loans from LMSC. HLS is not affiliated with the Company or its affiliates. As of September 30, 1996, the outstanding balance of loans sold under the facility was \$69,133,000 and there were no outstanding borrowings under the line of credit. Interest is payable on the line of credit based on certain commercial paper rates.

During the first quarter of 1995, the Company entered into a 10.43%, \$12,500,000 debt placement with an insurance company. Principal is payable monthly based on collection of the underlying collateral. The note is redeemable only with the approval of the noteholder. The note is collateralized by certain of the Company's investments in Class B subordinated pass-through certificates, excess servicing assets, and cash. At September 30, 1996, the remaining principal balance was \$7,866,000 and the value of the underlying collateral was approximately \$14,014,000.

On March 15, 1995, the Company completed a public offering of \$18,400,000 of 10% Notes due 2004. The Company repaid \$120,000 of these notes pursuant to the noteholders' annual redemption rights on April 1, 1996. On August 1, 1996 and June 1, 1996 the Company repaid \$20,000 and \$163,000, respectively of the 1993 Notes due 2003 pursuant to the noteholders' annual redemption rights.

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

Litchfield Financial Corporation (the "Company") is a specialty consumer finance company which provides financing for the purchase of rural and vacation properties ("Land Loans") and financing of vacation ownership interests ("VOI Loans"), popularly known as timeshare interests. In addition, the Company makes loans to rural land dealers and resort developers of vacation properties secured by consumer receivables and other secured loans (collectively "Dealer/Other Loans").

The principal sources of the Company's revenues are (i) interest income, (ii) gain from the sale of loans, (iii) loan origination and fee income and (iv) servicing income. Gains on sales of loans are based principally upon the present value of the difference between the interest to be collected from the borrower and the interest to be passed on to the purchaser of the loan during the estimated average life of the loans, less a normal servicing fee (referred to as "excess servicing asset"). In addition, the Company realizes gains from selling loans which were purchased at a discount. The excess servicing asset is amortized over the estimated term of the loans using the interest method. If prepayment or default assumptions prove inaccurate, then in subsequent periods the excess servicing asset may be adjusted for unfavorable changes. Because a significant portion of the Company's revenues is comprised of gains realized upon sales of loans, the timing of such sales has a significant effect on the Company's results of operations.

**Results of Operations**

The following table sets forth the percentage relationship to revenues, unless otherwise indicated, of certain items included in the Company's statements of income.

	Three months ended		Nine months ended	
	September 30,		September 30,	
	1996	1995	1996	1995
Revenues:				
Interest income	52.5%	51.5%	56.7%	60.9%
Gain on sale of loans	39.4	39.3	34.0	30.6
Loan origination and fee income	4.4	4.2	5.0	4.3
Servicing income	3.7	5.0	4.3	4.2
	-----	-----	-----	-----
	100.0	100.0	100.0	100.0
	-----	-----	-----	-----
Expenses:				
Interest expense	25.8	30.0	28.4	35.9
Salaries and employee benefits	11.3	11.7	13.1	12.6
Other operating expenses	12.6	12.1	12.2	12.4
Provision for loan losses	5.9	3.6	7.6	4.1
	-----	-----	-----	-----
	55.6	57.4	61.3	65.0
	-----	-----	-----	-----
Income before income taxes	44.4	42.6	38.7	35.0
Provision for income taxes	17.1	16.0	14.9	13.1
	-----	-----	-----	-----
Net income	27.3%	26.6%	23.8%	21.9%
	=====	=====	=====	=====

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Revenues increased 30.6% and 41.6% to \$7,136,000 and \$18,112,000 for the three and nine months ended September 30, 1996, from \$5,464,000 and \$12,788,000 for the same periods in 1995. Net income for the three and nine months ended September 30, 1996 increased 33.8% and 53.9% to \$1,946,000 and \$4,308,000 compared to \$1,454,000 and \$2,799,000 for the same periods in 1995. Net income as a percentage of revenues increased to 27.3% and 23.8% for the three and nine months ended September 30, 1996 compared to 26.6% and 21.9% for the three and nine months ended September 30, 1995.

Interest income increased 33.2% and 31.8% to \$3,747,000 and \$10,260,000 for the three and nine months ended September 30, 1996 from \$2,814,000 and \$7,786,000 for the same periods in 1995, primarily as the result of the increase in loans held for investment and subordinated pass-through certificates. Interest on loans and subordinated pass-through certificates, cash and investments, and excess servicing revenue comprised 80.3%, 6.3%, and 13.4% of interest income for the three months ended September 30, 1996, compared with 82.5%, 9.3%, and 8.2% in the same period in the prior year. Interest on loans and subordinated pass-through certificates, cash and investments, and excess servicing revenue comprised 82.7%, 7.9%, and 9.4% of interest income for the nine months ended September 30, 1996, compared with 80.7%, 10.4%, and 8.9% in the same period in the prior year. Interest earned on loans and subordinated pass through certificates increased 29.7% and excess servicing revenue increased 115.9%, while interest earned on cash and investments decreased 9.9%, for the three months ended September 30, 1996 compared to the same period in the prior year. Interest earned on loans and subordinated pass-through certificates increased 34.9% and excess servicing revenue increased 40.1%, while interest earned on cash and investments remained constant for the nine months ended September 30, 1996 compared to the same period in the prior year. The average rate earned on loans owned and subordinated pass-through certificates decreased to 12.7% for the three and the nine month periods ended September 30, 1996 from 13.4% and 13.1% for the three and nine month periods ended September 30, 1995.

Gain on the sale of loans increased 30.8% and 57.3% to \$2,811,000 and \$6,165,000 for the three and nine months ended September 30, 1996 from \$2,149,000 and \$3,920,000 for the same periods in 1995. The volume of loans sold increased 42.7% to \$21,582,000 for the three months ended September 30, 1996 from \$15,128,000 for the same period in 1995. The volume of loans sold decreased 17.4% to \$45,430,000 for the nine months ended September 30, 1996 from \$54,967,000 for the same period in 1995. The primary reason for the disproportionate increase in the gain on sale of loans despite the decrease in the loan sales was that the Company did not recognize any gain on the sale of \$27,155,000 of VOI Loans purchased from GEFICO in the second quarter of 1995. This was consistent with the purchase method of accounting.

Loan origination and fee income increased 38.8% and 64.4% to \$315,000 and \$904,000 for the three and nine months ended September 30, 1996 from \$227,000 and \$550,000 for the same periods in 1995. This increase in fee income primarily reflected an increase in Dealer/Other Loan originations during 1996.

Loans serviced for others increased 17.8% to \$125,793,000 as of September 30, 1996 from \$106,819,000 at September 30, 1995. Servicing income increased 47.2% to \$783,000 for the nine months ended September 30, 1996, from \$532,000 for the same period in 1995 because of the higher average Serviced Portfolio during the 1996 period, primarily as the result of the acquisition of the GEFICO portfolio in April 1995. Servicing income decreased 4.0%, to \$263,000 for the

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three months ended September 30, 1996 from \$274,000 for the same period in 1995, due to the decrease in the average servicing fee per loan. In connection with the Company's continued growth, the Company decided to subcontract its servicing rights in order to avoid incurring additional fixed overhead costs associated with such servicing. Accordingly, the Company subcontracted, to an unaffiliated third party, the servicing of VOI Loans in 1995 and the remaining loans in April 1996.

Interest expense increased 12.4% and 11.9% to \$1,843,000 and \$5,140,000 during the three and nine months ended September 30, 1996 from \$1,639,000 and \$4,593,000 for the same periods in 1995. During the three and nine months ended September 30, 1996, borrowings averaged \$72,379,000 and \$66,972,000 respectively, at an average rate of 9.3% and 9.2%, respectively, compared to \$59,697,000 and \$54,628,000 at average rates of 9.8% and 9.7% during the same periods in 1995. Average borrowings increased proportionately more than interest expense because of the Company's ability to secure financing at more favorable interest rates in 1996. Interest expense includes the amortization of deferred debt issuance costs.

Salaries and employee benefits increased 25.9% to \$806,000 for the three months ended September 30, 1996 from \$640,000 for the same period in 1995, Salaries and employee benefits increased 46.8%, to \$2,372,000 for the nine months ended September 30, 1996 from \$1,616,000 for the same period in 1995, because of an increase in certain incentive based compensation due to higher originations and an increase in the average number of employees during the 1996 period. The total full time equivalent employees increased to 56 in September 1996 from 55 in September 1995. The average number of employees working during the 1996 periods increased due to hiring additional staff to support the growth in the Serviced Portfolio. Personnel costs as a percentage of revenues decreased slightly to 11.3% for the three months ended September 30, 1996 from 11.7% for the same period in 1995. Personnel costs as a percentage of revenues increased slightly to 13.1% for nine months ended September 30, 1996 from 12.6% for the same period in 1995.

Other operating expenses increased 35.4% and 40.4% to \$898,000 and \$2,219,000 for the three and nine months ended September 30, 1996 from \$663,000 and \$1,580,000 for the same periods in 1995, primarily due to the growth in the Serviced Portfolio. Other operating expenses increased to 12.6% as a percentage of revenue for the three months ended September 30, 1996 compared to 12.1% for the same period in 1995. Other operating expenses as a percentage of revenue remained relatively constant at 12.2% for the nine months ended September 30, 1996 compared to 12.4% for the same period in 1995.

During the three and nine months ended September 30, 1996, the Company increased its provision for loan losses 115.4% and 165.2%, to \$420,000 and \$1,374,000 from \$195,000 and \$518,000 for the same periods in 1995, primarily as the result of the overall increase in the Serviced Portfolio as well as the proportionate increase in the percentage of non-guaranteed loans in the Serviced Portfolio. Historically, the loan loss rate for non-guaranteed loans has been higher than the rate for guaranteed loans.

### **Liquidity and Capital Resources**

The Company's business requires continued access to short and long-term sources of debt financing and equity capital. The Company's cash requirements



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arise from loan originations and purchases, repayment of debt upon maturity, payments of operating and interest expenses and loan repurchases. The Company's primary sources of liquidity are sales into secondary markets of the loans it originates and purchases, short-term borrowings under warehouse lines secured by pledges of its loans (in most cases until such loans are sold and the lenders can be repaid), long-term debt and equity offerings, and cash flows from operations.

In connection with the Company's practice of selling the loans which it originates and purchases, the Company in some cases commits to repurchase from investors any such loans that become 90 days or more past due. This obligation is subject to various terms and conditions, including, in some instances, a limitation on the amount of loans that may be required to be repurchased. Based on the Company's repurchase obligations contained in certain of its loan sale contracts, there were approximately \$8,839,000 of loans at September 30, 1996 which the Company could be required to repurchase in the future should such loans become 90 days or more past due. The Company repurchased \$264,000 and \$778,000 of such loans under the recourse provisions of loan sales during the three and nine months ended September 30, 1996. Also, in connection with certain securitization programs, \$17,734,000 of cash and cash equivalents are restricted as credit enhancements at September 30, 1996.

The Company funds its loan purchases in part with borrowings under various bank warehouse lines of credit. Warehouse lines are paid down when the Company receives the proceeds from the sale of the loans or when cash is otherwise available. At September 30, 1996, the Company had a secured warehouse line of credit of \$20,000,000 with an over line of \$5,000,000 from the Bank of Boston. The Company can elect to borrow all or part of the outstanding balance on the line of credit and the over line at either the Bank's prime interest rate or the Eurodollar rate plus 2%. Outstanding borrowings under the line of credit and the over line at September 30, 1996 were \$21,600,000. On October 2, 1996, the warehouse line of credit was amended to include a \$10,000,000 syndication with Fleet Bank - NH. The borrowings on the over line were incorporated into the amended facility and the over line expired. Bank of Boston is the agent bank for the facility. The warehouse line of credit matures in April 1997, with renewal at the lender's discretion. At December 31, 1995 the secured warehouse line of credit was \$15,000,000 at the Bank's prime interest rate plus 1%. There were no outstanding borrowings at December 31, 1995. On July 23, 1996, the Company entered into an additional secured line of credit of \$5,000,000 with another financial institution at that institution's prime rate of interest plus 1.25%. This warehouse line of credit matures in July 1997. There were no outstanding borrowings on this line of credit at September 30, 1996. The lines of credit are secured by consumer receivables and other secured loans. On September 13, 1996, the Company entered into a \$15,000,000 revolving line of credit facility with the Bank of Scotland. The facility is secured by certain subordinated pass-through certificates and excess servicing assets and matures in September 1999. Interest is payable quarterly in arrears at the Bank's prime interest rate plus 1%. There were no outstanding borrowings under this facility at September 30, 1996. The Company is not required to maintain compensating balances or forward sales commitments under the terms of these lines of credit. As of September 30, 1996 and December 31, 1995, the Company had no unsecured lines of credit.

The Company also has a revolving line of credit as part of an asset backed commercial paper facility with Holland Limited Securitization, Inc. ("HLS") a multi-seller commercial paper issuer sponsored by Internationale Nederlanden (U.S.) Capital Markets, Inc. ("ING"). In October 1996, the Company amended the facility to increase the facility to \$100 million, subject to certain terms and conditions, reduce certain credit enhancement requirements and expand certain loan eligibility criteria. The facility expires in June 1998.

## FORM 10-Q

In connection with the HLS facility, the Company formed a wholly owned subsidiary, Litchfield Mortgage Securities Corporation 1994 ("LMSC"), to purchase loans from the Company. LMSC either pledges the loans on a revolving line of credit with HLS or sells the loans to HLS. HLS issues commercial paper or other indebtedness to fund the purchase or pledge of loans from LMSC. HLS is not affiliated with the Company or its affiliates. As of September 30, 1996, the outstanding balance of loans sold under the facility was \$69,133,000 and there were no outstanding borrowings under the line of credit. Interest is payable on the line of credit based on certain commercial paper rates.

During the first quarter of 1995, the Company entered into a 10.43%, \$12,500,000 debt placement with an insurance company. Principal is payable monthly based on collection of the underlying collateral. The note is redeemable only with the approval of the noteholder. The note is collateralized by certain of the Company's investments in Class B subordinated pass-through certificates, excess servicing assets, and cash. At September 30, 1996, the balance outstanding on the note was \$7,866,000 and the value of the underlying collateral was approximately \$14,014,000.

On March 15, 1995, the Company completed a public offering of \$18,400,000 of 10% Notes due 2004 ("1995 Notes"). The 1995 Notes allow for a maximum annual redemption of \$920,000 and contain certain restrictions regarding the payment of dividends and require the maintenance of certain financial ratios. On April 1, 1996 the noteholders redeemed, and the Company paid \$120,000 of the 1995 Notes. On October 31, 1995, the Company completed a public offering of 1,250,000 shares of common stock at a price of \$15 per share. The net proceeds to the Company were approximately \$17,325,000 after deducting expenses related to the offering.

Previously, the Company significantly increased its capital base through a \$9,500,000 initial public offering in February, 1992 and public debt offerings of \$15,065,000 in November 1992 ("1992 Notes") and \$17,570,000 in May 1993 ("1993 Notes"). The 1992 Notes and the 1993 Notes bear interest at 10% and 8 7/8%, respectively, and are due 2002 and 2003, respectively. The 1992 Notes and the 1993 Notes are unsecured obligations of the Company and each such issuance allows for a maximum annual redemption by noteholders of 5% of the original principal amount thereof. On August 1, 1996 and June 1, 1996 the Company repaid \$20,000 and \$163,000, respectively of the 1993 Notes due 2003 pursuant to the noteholders' annual redemption rights.

The Company manages its exposure to changes in interest rates by attempting to match its proportion of fixed versus variable rate assets, liabilities and loan sale facilities. The Company has mitigated its interest rate exposure due to interest rate declines by instituting interest rate floors on its adjustable rate loans.

Historically, the Company has not required major capital expenditures to support its operations.

### **Credit Quality and Allowances for Loan Losses**

The Company maintains allowances for loan losses at levels which, in the opinion of management, provide adequately for current and possible future losses on loans, loans sold and subordinated pass-through certificates. Past-due loans (loans 30 days or more past due which are not covered by dealer/developer reserves and guarantees) as a percentage of the Serviced Portfolio were 1.43% as of September 30, 1996. Management evaluates the adequacy of the allowances on a

FORM 10-Q quarterly basis by examining current delinquencies, the characteristics of the accounts, the value of the underlying collateral, and general economic conditions and trends. Management also evaluates the extent to which dealer/developer reserves and guarantees can be expected to absorb loan losses. A provision for loan losses is recorded in an amount deemed sufficient by management to maintain the allowances at adequate levels. Total allowances for loan losses and loans sold increased to \$4,318,000 at September 30, 1996 compared to \$3,715,000 at December 31, 1995. The allowance ratio (the allowances for loan losses divided by the amount of the Serviced Portfolio) at September 30, 1996 decreased slightly to 1.96% from 2.10% at December 31, 1995.

As part of the Company's financing of Land Loans and VOI Loans, arrangements are entered into with dealers and resort developers, whereby reserves are established to protect the Company from potential losses associated with such loans. As part of the Company's agreement with the dealers and resort developers, a portion of the amount payable to each dealer and resort developer for a Land Loan or a VOI Loan is retained by the Company and is available to the Company to absorb loan losses for those loans. The Company negotiates the amount of the reserves with the dealers and developers based upon various criteria, two of which are the financial strength of the dealer or developer and credit risk associated with the loans being purchased. Dealer/developer reserves amounted to \$9,951,000 and \$9,644,000 at September 30, 1996 and December 31, 1995, respectively.

### **Inflation**

Inflation has not had a significant effect on the Company's operating results to date.

**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

None

**Item 2. Changes in Securities**

None

**Item 3. Defaults Upon Senior Securities**

None

**Item 4. Submission of Matters to a Vote of Security Holders**

None

**Item 5. Other Information**

None

**Item 6. (a) Exhibits**

The following exhibits are filed herewith:

11.1 -- Statement re: computation of earnings per share

27.1 -- Financial Data Schedule

(b) Reports on Form 8-K

None

**FORM 10-Q**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**LITCHFIELD FINANCIAL CORPORATION**

*DATE: November 12, 1996*

*/s/ Richard A. Stratton  
RICHARD A. STRATTON  
Chief Executive Officer,  
President and Director*

*DATE: November 12, 1996*

*/s/ Ronald E. Rabidou  
RONALD E. RABIDOU  
Chief Financial Officer*

**Exhibit 11.1**

## Litchfield Financial Corporation

## Computation of Earnings Per Share

	Three months ended		Nine months ended	
	September 30,		September 30,	
	1996	1995	1996	1995
Net Income	\$1,946,000 =====	\$1,454,000 =====	\$4,308,000 =====	\$2,799,000 =====
Net income per common share	\$ .34 =====	\$ .33 =====	\$ .75 =====	\$ .64 =====
Weighted average number of common shares outstanding	5,443,319	4,120,675	5,440,745	4,103,811
Weighted average number of common stock equivalents outstanding: Stock Options	277,605 -----	291,691 -----	274,646 -----	294,986 -----
Fully diluted weighted average common and common equivalent shares outstanding (1)	5,720,924 =====	4,412,366 =====	5,715,391 =====	4,398,797 =====

(1) Primary weighted average number of common stock equivalents were 5,697,127 and 5,681,431 for the three and nine months ended September 30, 1996 and 4,395,274 and 4,287,744 for the three and nine months ended September 30, 1995, respectively. The difference between primary and fully diluted shares outstanding did not have a material effect on the calculation of earnings per share.

**ARTICLE 5**

CIK: 0000882515

NAME: LITCHFIELD FINANCIAL CORPORATION

MULTIPLIER: 1,000

PERIOD TYPE	9 MOS
FISCAL YEAR END	DEC 31 1995
PERIOD START	JAN 01 1996
PERIOD END	SEP 30 1996
CASH	28,552
SECURITIES	17,648
RECEIVABLES	72,588
ALLOWANCES	4,318
INVENTORY	0
CURRENT ASSETS	0
PP&E	0
DEPRECIATION	0
TOTAL ASSETS	137,258
CURRENT LIABILITIES	0
BONDS	47,098
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	55
OTHER SE	41,701
TOTAL LIABILITY AND EQUITY	137,258
SALES	0
TOTAL REVENUES	18,112
CGS	0
TOTAL COSTS	0
OTHER EXPENSES	0
LOSS PROVISION	1,374
INTEREST EXPENSE	5,140
INCOME PRETAX	7,007
INCOME TAX	2,699
INCOME CONTINUING	4,308
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	4,308
EPS PRIMARY	0.75
EPS DILUTED	0.75

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