

First Financial Northwest, Inc.
Form 10-Q
August 07, 2012

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 June 30, 2012

or

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

For the transition period from _____ to _____

Commission File Number: 001-33652

FIRST FINANCIAL NORTHWEST, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of incorporation or organization)

__ 26-0610707__
(I.R.S. Employer Identification Number)

201 Wells Avenue South, Renton, Washington _
(Address of principal executive offices)

98057
(Zip Code)

Registrant's telephone number, including area code: _____(425) 255-4400_____

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Edgar Filing: First Financial Northwest, Inc. - Form 10-Q

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of August 3, 2012, 18,805,168 shares of the issuer's common stock, \$0.01 par value per share, were outstanding.

1

FIRST FINANCIAL NORTHWEST, INC.
FORM 10-Q
TABLE OF CONTENTS

PART 1 FINANCIAL INFORMATION

Item 1	Financial Statements	3
Item 2	Management's Discussion and Analysis of Financial Condition and Results of Operations	36
Item 3	Quantitative and Qualitative Disclosures About Market Risk	54
Item 4	Controls and Procedures	57
PART II - OTHER INFORMATION		
Item 1	Legal Proceedings	58
Item 1A	Risk Factors	58
Item 2	Unregistered Sales of Equity Securities and Use of Proceeds	58
Item 3	Defaults upon Senior Securities	58
Item 4	Mine Safety Disclosures	58
Item 5	Other Information	58
Item 6	Exhibits	58

SIGNATURES

60

2

Item 1. Financial Statements

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands, except share data)
(Unaudited)

Assets	June 30, 2012	December 31, 2011
Cash on hand and in banks	\$ 4,670	\$ 4,620
Interest-bearing deposits	155,327	160,141
Investments available-for-sale, at fair value	130,483	129,002
Loans receivable, net of allowance of \$14,450 and \$16,559	649,965	703,288
Premises and equipment, net	18,448	18,922
Federal Home Loan Bank stock, at cost	7,413	7,413
Accrued interest receivable	3,665	3,856
Federal income tax receivable	1,072	1,060
Deferred tax assets	1,000	-
Other real estate owned ("OREO")	22,206	26,044
Prepaid expenses and other assets	4,429	5,044
Total assets	\$ 998,678	\$ 1,059,390
Liabilities and Stockholders' Equity		
Interest-bearing deposits	\$ 719,035	\$ 782,652
Noninterest-bearing deposits	5,828	6,013
Advances from the Federal Home Loan Bank	83,066	83,066
Advance payments from borrowers for taxes and insurance	2,459	2,093
Accrued interest payable	180	184
Other liabilities	3,938	4,062
Total liabilities	814,506	878,070
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, \$0.01 par value; authorized 10,000,000 shares, no shares issued or outstanding	-	-
Common stock, \$0.01 par value; authorized 90,000,000 shares; issued and outstanding 18,805,168 shares at June 30, 2012 and December 31, 2011	188	188
Additional paid-in capital	189,602	188,816
Retained earnings, substantially restricted	5,930	3,937
Accumulated other comprehensive income, net of tax	20	511
Unearned Employee Stock Ownership Plan ("ESOP") shares	(11,568)	(12,132)
Total stockholders' equity	184,172	181,320

Total liabilities and stockholders' equity	\$ 998,678	\$ 1,059,390
--	------------	--------------

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES

Consolidated Income Statements
(Dollars in thousands, except share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Interest income				
Loans, including fees	\$ 9,802	\$ 11,891	\$ 20,274	\$ 24,319
Investments available-for-sale	500	1,262	1,093	2,467
Interest-bearing deposits	97	94	194	170
Total interest income	\$ 10,399	\$ 13,247	\$ 21,561	\$ 26,956
Interest expense				
Deposits	2,627	4,220	5,568	8,733
Federal Home Loan Bank advances	511	583	1,022	1,159
Total interest expense	\$ 3,138	\$ 4,803	\$ 6,590	\$ 9,892
Net interest income	7,261	8,444	14,971	17,064
Provision for loan losses	650	1,600	2,350	2,800
Net interest income after provision for loan losses	\$ 6,611	\$ 6,844	\$ 12,621	\$ 14,264
Noninterest income				
Net gain on sale of investments	94	751	288	1,262
Other	236	75	323	160
Total noninterest income	\$ 330	\$ 826	\$ 611	\$ 1,422
Noninterest expense				
Compensation and employee benefits	3,451	3,214	6,878	6,503
Occupancy and equipment	395	395	800	797
Professional fees	468	502	941	982
Data processing	185	183	366	392
Gain on sale of OREO property, net	(128)	(508)	(349)	(1,134)
OREO market value adjustments	235	289	545	917
OREO related expenses, net	446	986	935	1,836
Regulatory assessments	314	612	411	1,322
Insurance and bond premiums	100	248	200	495
Proxy contest and related litigation	604	-	604	-
Marketing	61	50	113	111
Other general and administrative	438	441	746	773
Total noninterest expense	\$ 6,569	\$ 6,412	\$ 12,190	\$ 12,994
Income before federal income tax benefit	372	1,258	1,042	2,692
Federal income tax benefit	(999)	-	(951)	-
Net income	\$ 1,371	\$ 1,258	\$ 1,993	\$ 2,692
Basic earnings per share				
Basic earnings per share	\$ 0.08	\$ 0.07	\$ 0.11	\$ 0.15
Diluted earnings per share				
Diluted earnings per share	\$ 0.08	\$ 0.07	\$ 0.11	\$ 0.15

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
 Consolidated Statements of Comprehensive Income
 (In thousands)
 (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net Income	\$ 1,371	\$ 1,258	\$ 1,993	\$ 2,692
Other comprehensive income, before tax				
Unrealized holding gains (losses) on available-for-sale securities	(455)	1,592	(203)	1,658
Reclassification adjustment for net gains realized in income	(94)	(751)	(288)	(1,262)
Other comprehensive income (loss), before tax	(549)	841	(491)	396
Income tax benefit related to items of other comprehensive income	-	-	-	(430)
Other comprehensive income (loss), net of tax	\$ (549)	\$ 841	\$ (491)	\$ 826
Total comprehensive income	\$ 822	\$ 2,099	\$ 1,502	\$ 3,518

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
 Consolidated Statements of Stockholders' Equity
 For the Six Months Ended June 30, 2012
 (Dollars in thousands, except share data)
 (unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2011	18,805,168	\$ 188	\$188,816	\$3,937	\$ 511	\$(12,132)	\$ 181,320
Comprehensive income:							
Net income	-	-	-	1,993	-	-	1,993
Change in fair value of investments available-for-sale	-	-	-	-	(491)	-	(491)
Total comprehensive income							1,502
Compensation related to stock options and restricted stock awards	-	-	932	-	-	-	932
Allocation of 56,426 ESOP shares	-	-	(146)	-	-	564	418
Balances at June 30, 2012	18,805,168	\$ 188	\$189,602	\$5,930	\$ 20	\$(11,568)	\$ 184,172

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

	Six Months Ended June 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 1,993	\$ 2,692
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	2,350	2,800
OREO market value adjustments	545	917
Gain on sale of OREO property, net	(349)	(1,134)
Depreciation of premises and equipment	524	532
Net amortization of premiums and discounts on investments	884	1,275
ESOP expense	418	307
Compensation expense related to stock options and restricted stock awards	932	950
Net realized gain on investments available-for-sale	(288)	(1,262)
Loss from disposal of premises and equipment	6	-
Deferred federal income taxes	(998)	430
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	615	1,182
Federal income tax receivable	(12)	(430)
Accrued interest receivable	191	554
Accrued interest payable	(4)	3
Other liabilities	(124)	(79)
Net cash provided by operating activities	\$ 6,683	\$ 8,737
Cash flows from investing activities:		
Proceeds from sales or calls of investments	23,199	31,035
Capitalized improvements in OREO	-	(90)
Proceeds from sales of OREO properties	11,664	20,380
Principal repayments on investments	11,023	17,570
Purchases of investments	(36,792)	(25,451)
Net decrease in loans receivable	42,951	85,072
Purchases of premises and equipment	(56)	(31)
Net cash provided by investing activities	\$ 51,989	\$ 128,485
Balance, carried forward	\$ 58,672	\$ 137,222

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)

	Six Months Ended June 30,	
	2012	2011
Balance, brought forward	\$ 58,672	\$ 137,222
Cash flows from financing activities:		
Net decrease in deposits	(63,802)	(46,529)
Advances from the Federal Home Loan Bank	110	-
Repayments of advances from the Federal Home Loan Bank	(110)	-
Net increase (decrease) in advance payments from borrowers for taxes and insurance	366	(308)
Net cash used by financing activities	\$ (63,436)	\$ (46,837)
Net increase (decrease) in cash	(4,764)	90,385
Cash and cash equivalents:		
Beginning of period	164,761	98,427
End of period	\$ 159,997	\$ 188,812
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 6,594	\$ 9,889
Federal income taxes	\$ 60	\$ -
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan losses, transferred to OREO	\$ 8,022	\$ 15,950

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Description of Business

First Financial Northwest, Inc. (“First Financial Northwest” or the “Company”), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest (“First Savings Bank” or “the Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information presented in the consolidated financial statements and related data, relates primarily to First Savings Bank. First Financial Northwest is a savings and loan holding company and is subject to regulation by the Federal Reserve Board (“FRB”). First Savings Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”).

First Savings Bank is a community-based savings bank primarily serving King, and to a lesser extent, Pierce, Snohomish and Kitsap counties through our full-service banking office located in Renton, Washington. First Savings Bank’s business consists of attracting deposits from the public and utilizing these deposits to originate one-to-four family residential, multifamily, commercial real estate, business, consumer and construction/land development loans.

As used throughout this report, the terms “we”, “our”, “us”, or the “Company” refer to First Financial Northwest, Inc. and its consolidated subsidiary First Savings Bank Northwest, unless the context otherwise requires.

Note 2 – Regulatory Items

On April 14, 2010, the Office of Thrift Supervision (“OTS”) and members of the Board of Directors of First Financial Northwest entered into an informal supervisory agreement or Memorandum of Understanding (“MOU”), which is now enforced by the FRB, the successor to the OTS as the regulator of the holding company. Under the terms of the MOU, the Company agreed, among other things, to provide notice to and obtain a written non-objection from the FRB prior to the Company (a) declaring a dividend or redeeming any capital stock and (b) incurring, issuing, renewing or repurchasing any new debt.

On March 27, 2012, the Bank’s regulators, the FDIC and the DFI terminated the Consent Order (“Order”) which became effective on September 24, 2010. In place of the Order, the Bank entered into an MOU, which is an informal regulatory action with the FDIC and DFI. The Order was terminated as a result of the steps the Bank took in complying with the Order and reducing its level of classified assets, increasing earnings, augmenting management and improving the overall condition of the Bank.

The MOU with the Bank contains provisions concerning the management and directors of the Bank, interest rate risk, minimum capital levels, the allowance for loan and lease losses (“ALLL”), lending and collection policies, policies concerning the Bank and its affiliates, restrictions on paying dividends and a requirement to furnish progress reports to the FDIC and DFI. A copy of the MOU with the Bank is attached to the Form 8-K that we filed with the Securities and Exchange Commission (“SEC”) on April 2, 2012.

Note 3 – Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information and footnotes required by U.S.

Generally Accepted Accounting Principles (“GAAP”) for complete financial statements. These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements in accordance with GAAP have been included. All significant intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the three and six months

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. In preparing the unaudited consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the ALLL, the valuation of other real estate owned (“OREO”) and the underlying collateral of loans in the process of foreclosure, deferred tax assets and the fair value of financial instruments.

Certain amounts in the unaudited consolidated financial statements for prior periods have been reclassified to conform to the current unaudited financial statement presentation.

Note 4 – Recently Issued Accounting Pronouncements

In April 2011, the Financial Accounting Standards Board (“FASB”) issued ASU No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The update amends existing guidance to remove from the assessment of effective control, the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and, as well, the collateral maintenance implementation guidance related to that criterion. The provisions of ASU No. 2011-03 were effective for the Company’s reporting period beginning on or after December 15, 2011. The guidance applied prospectively to transactions or modifications of existing transactions that occurred on or after the effective date and early adoption was not permitted. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (International Financial Reporting Standards). The update amends existing guidance regarding the highest and best use and valuation premise by clarifying these concepts are only applicable to measuring the fair value of nonfinancial assets. The Update also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well as disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value is required. The provisions of ASU No. 2011-04 were effective for the Company’s reporting period beginning after December 15, 2011 and were applied prospectively. The adoption of this ASU did not have a material impact on the Company’s consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The update amends current guidance to allow a company the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions do not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The amendments do not change the option for a company to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense (benefit) related to the total of other comprehensive income items. The amendments do not affect how earnings per share is calculated or presented. The provisions of ASU No. 2011-05 were effective for

the Company's reporting periods beginning after December 15, 2011 and were applied retrospectively. Early adoption was permitted and there were no required transition disclosures. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The update requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 ("ASU 2011-12"). This ASU defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. ASU 2011-12 was issued in order to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company will continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before the issuance of ASU 2011-05. ASU 2011-12 was effective for the Company's financial statements for annual and interim periods beginning after December 31, 2011, and was applied prospectively. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-2, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment ("ASU 2012-2"). This ASU states that an entity has the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount, in accordance with Codification Subtopic 350-30, Intangibles—Goodwill and Other, General Intangibles Other than Goodwill. Under guidance in this ASU, an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. The amendments in this ASU are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
 SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

Note 5 – Investments

Investment securities available-for-sale are summarized as follows:

	June 30, 2012			Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Mortgage-backed investments:				
Fannie Mae	\$40,956	\$993	\$(36)	\$41,913
Freddie Mac	17,835	392	(37)	18,190
Ginnie Mae	6,025	59	-	6,084
Municipal bonds	2,050	26	(284)	1,792
U.S. Government sponsored entities and agencies	62,809	23	(328)	62,504
Total	\$129,675	\$1,493	\$(685)	\$130,483
December 31, 2011				
	Gross			Fair Value
	Amortized Cost	Unrealized Gains	Unrealized Losses	
(In thousands)				
Mortgage-backed investments:				
Fannie Mae	\$50,981	\$1,182	\$-	\$52,163
Freddie Mac	19,285	560	-	19,845
Ginnie Mae	7,416	79	-	7,495
Municipal bonds	2,085	32	(270)	1,847
U.S. Government sponsored entities and agencies	47,934	2	(284)	47,652
Total	\$127,701	\$1,855	\$(554)	\$129,002

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
 SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (Unaudited)

The following table summarizes the aggregate fair value and gross unrealized loss by length of time those investments have been continuously in an unrealized loss position:

	Less Than 12 Months		June 30, 2012 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	\$9,987	\$(36)	\$-	\$-	\$9,987	\$(36)
Freddie Mac	3,153	(37)	-	-	3,153	(37)
Municipal bonds	-	-	1,122	(284)	1,122	(284)
U.S Government sponsored						