

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, 2001

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 0-28312

FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.

(Exact name of registrant as specified in its charter)

Texas

(State or other jurisdiction of incorporation  
or organization)

71-0785261

(I.R.S. Employer  
Identification Number)

200 West Stephenson  
Harrison, Arkansas

(Address of principal executive office)

72601

(Zip Code)

(870) 741-7641

(Registrant's telephone number, including area code)

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 the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 14, 2001, there were issued and outstanding 3,171,699 shares of the Registrant's Common Stock, par value \$.01 per share.

# FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.

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**FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
(In Thousands)

ASSETS	September 30, 2001 <u>(Unaudited)</u>	December 31, 2000 <u></u>
Cash and cash equivalents	\$ 49,268	\$ 11,564
Investment securities - held to maturity	133,039	184,310
Federal Home Loan Bank stock	4,881	5,098
Loans receivable, net of allowance	482,337	498,305
Accrued interest receivable	5,261	6,910
Real estate acquired in settlement of loans, net	299	261
Office properties and equipment, net	7,000	7,170
Prepaid expenses and other assets	<u>15,580</u>	<u>284</u>
<b>TOTAL ASSETS</b>	<b><u>\$697,665</u></b>	<b><u>\$713,902</u></b>
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>LIABILITIES:</b>		
Deposits	\$552,079	\$540,327
Federal Home Loan Bank advances	55,848	93,359
Advance payments by borrowers for taxes and insurance	823	1,006
Other liabilities	<u>16,466</u>	<u>2,588</u>
Total liabilities	<u>625,216</u>	<u>637,280</u>
 <b>STOCKHOLDERS' EQUITY:</b>		
Preferred stock, no par value, 5,000,000 shares authorized, none issued		
Common stock, \$.01 par value, 20,000,000 shares authorized, 5,153,751 shares issued, 3,181,667 and 3,553,981 shares outstanding at September 30, 2001 and December 31, 2000, respectively	52	52
Additional paid-in capital	51,331	51,045
Employee stock benefit plans	(2,071)	(2,680)
Retained earnings-substantially restricted	<u>59,436</u>	<u>56,713</u>
	108,748	105,130
Treasury stock, at cost, 1,972,084 and 1,599,770 shares at September 30, 2001 and December 31, 2000, respectively	<u>(36,299)</u>	<u>(28,508)</u>
Total stockholders' equity	<u>72,449</u>	<u>76,622</u>
 <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	 <b><u>\$697,665</u></b>	 <b><u>\$713,902</u></b>

See notes to unaudited consolidated financial statements.

**FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(In thousands, except earnings per share)  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2001	2000	2001	2000
<b>INTEREST INCOME:</b>				
Loans receivable	\$ 9,856	\$ 9,811	\$29,956	\$28,391
Investment securities	2,323	3,383	7,777	10,196
Other	233	24	638	74
Total interest income	<u>12,412</u>	<u>13,218</u>	<u>38,371</u>	<u>38,661</u>
<b>INTEREST EXPENSE:</b>				
Deposits	6,801	7,105	21,232	20,252
Other borrowings	946	1,521	3,506	4,026
Total interest expense	<u>7,747</u>	<u>8,626</u>	<u>24,738</u>	<u>24,278</u>
<b>NET INTEREST INCOME</b>	4,665	4,592	13,633	14,383
<b>PROVISION FOR LOAN LOSSES</b>	<u>102</u>	<u>--</u>	<u>163</u>	<u>--</u>
<b>NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES</b>	<u>4,563</u>	<u>4,592</u>	<u>13,470</u>	<u>14,383</u>
<b>NONINTEREST INCOME:</b>				
Deposit fee income	312	280	955	775
Other	615	284	1,502	625
Total noninterest income	<u>927</u>	<u>564</u>	<u>2,457</u>	<u>1,400</u>
<b>NONINTEREST EXPENSES:</b>				
Salaries and employee benefits	1,899	2,006	6,548	5,864
Net occupancy expense	284	285	843	816
Federal insurance premiums	25	27	76	79
Provision for real estate losses	2	6	8	14
Data processing	276	217	807	677
Postage and supplies	118	108	399	350
Other	542	443	1,595	1,432
Total noninterest expenses	<u>3,146</u>	<u>3,092</u>	<u>10,276</u>	<u>9,232</u>
<b>INCOME BEFORE INCOME TAXES</b>	2,344	2,064	5,651	6,551
<b>INCOME TAX PROVISION</b>	<u>727</u>	<u>678</u>	<u>1,828</u>	<u>2,163</u>
<b>NET INCOME</b>	<u>\$ 1,617</u>	<u>\$ 1,386</u>	<u>\$ 3,823</u>	<u>\$ 4,388</u>
<b>EARNINGS PER SHARE:</b>				
Basic	<u>\$ 0.53</u>	<u>\$ 0.41</u>	<u>\$ 1.21</u>	<u>\$ 1.23</u>
Diluted	<u>\$ 0.52</u>	<u>\$ 0.41</u>	<u>\$ 1.20</u>	<u>\$ 1.23</u>
Cash Dividends Declared	<u>\$ 0.11</u>	<u>\$ 0.10</u>	<u>\$ 0.33</u>	<u>\$ 0.30</u>

See notes to unaudited consolidated financial statements.

**FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2001**  
(In Thousands)  
(Unaudited)

	<u>Issued Common Stock</u>		Additional Paid-In Capital	Employee Stock Benefit Plans	Retained Earnings	<u>Treasury Stock</u>		Total Stockholders' Equity
	<u>Shares</u>	<u>Amount</u>				<u>Shares</u>	<u>Amount</u>	
Balance, December 31, 2000	5,153,751	\$52	\$51,045	\$(2,680)	\$56,713	1,599,770	\$(28,508)	\$76,622
Net income					3,823			3,823
Release of ESOP shares			286	312				598
Stock compensation expense				297				297
Purchase of treasury stock, at cost						372,314	(7,791)	(7,791)
Dividends paid					(1,100)			(1,100)
Balance, September 30, 2001	<u>5,153,751</u>	<u>\$ 52</u>	<u>\$51,331</u>	<u>\$(2,071)</u>	<u>\$59,436</u>	<u>1,972,084</u>	<u>\$(36,299)</u>	<u>\$72,449</u>

See notes to unaudited consolidated financial statements.

**FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Thousands)  
(Unaudited)

	Nine Months Ended September 30,	
	2001	2000
<b>OPERATING ACTIVITIES:</b>		
Net income	\$3,823	\$4,388
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	163	--
Provision for real estate losses	8	14
Deferred tax provision	91	293
Federal Home Loan Bank stock dividends	(169)	(284)
Federal Home Loan Bank stock redeemed	385	--
Loss (gain) on sale of repossessed assets, net	13	(5)
Originations of loans held for sale	(38,664)	(4,468)
Proceeds from sales of loans	37,565	4,368
Gain on sale of mortgage loans originated to sell	(437)	(47)
Depreciation	528	498
Depreciation on real estate owned	--	32
Accretion of deferred loan fees, net	(433)	(358)
Release of ESOP shares	628	487
Stock compensation expense	297	592
Changes in operating assets & liabilities:		
Accrued interest receivable	1,649	187
Prepaid expenses & other assets	(271)	196
Other liabilities	353	280
Net cash provided by operating activities	5,529	6,173
<b>INVESTING ACTIVITIES:</b>		
Purchases of investment securities-held to maturity	(30,404)	(11,017)
Proceeds from maturities/calls of investment securities-held to maturity	95,080	6,000
Purchase of bank owned life insurance	(15,000)	--
Loan (originations), net of repayments	17,337	(31,745)
Proceeds from sales of repossessed assets	354	2,898
Purchases of office properties and equipment	(359)	(901)
Net cash provided (used) by investing activities	67,008	(34,765)

(Continued)

FINANCING ACTIVITIES:

Net increase in deposits	11,752	28,163
Advances from FHLB	2,450	116,575
Repayment of advances from FHLB	(39,961)	(105,785)
Net decrease in advance payments by borrowers for taxes & insurance	(183)	(264)
Purchase of treasury stock	(7,791)	(7,332)
Dividends paid	(1,100)	(1,121)
Distributions related to minority interest	<u>    --</u>	<u>    (793)</u>
Net cash provided (used) by financing activities	<u>(34,833)</u>	<u>    29,443</u>

Net increase in cash and cash equivalents	37,704	851
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CASH AND CASH EQUIVALENTS:

Beginning of period	<u>11,564</u>	<u>9,983</u>
End of period	<u>\$ 49,268</u>	<u>\$10,834</u>

SUPPLEMENTAL DISCLOSURES OF  
CASH FLOW INFORMATION:

Cash paid for:		
Interest	<u>\$ 25,117</u>	<u>\$ 23,967</u>
Income taxes	<u>\$ 1,687</u>	<u>\$ 1,765</u>

SUPPLEMENTAL SCHEDULE OF NONCASH  
INVESTING ACTIVITIES:

Real estate acquired in settlement of loans	<u>\$ 357</u>	<u>\$ 347</u>
Loans to facilitate sales of real estate owned	<u>    --</u>	<u>\$ 1,170</u>
Investment securities traded, recorded in investments, not yet settled in cash	<u>\$ 13,405</u>	<u>    --</u>
		(Concluded)

See notes to unaudited consolidated financial statements.

## FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.

### NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

#### Note 1 - Basis of Presentation and Principles of Consolidation

First Federal Bancshares of Arkansas, Inc. (the "Corporation") is a unitary holding company which owns all of the stock of First Federal Bank of Arkansas, FA (the "Bank"). The Bank provides a broad line of financial products to individuals and small to medium-sized businesses. The consolidated financial statements also include the accounts of the Bank's wholly-owned subsidiary, First Harrison Service Corporation ("FHSC"), whose activities are limited.

The accompanying unaudited consolidated financial statements of the Corporation have been prepared in accordance with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, such information reflects all adjustments which are, in the opinion of management, necessary for a fair statement of results for the interim periods.

The accompanying consolidated financial statements include the accounts of the Corporation and the Bank. All material intercompany transactions have been eliminated in consolidation.

The results of operations for the nine months ended September 30, 2001 are not necessarily indicative of the results to be expected for the year ending December 31, 2001. The unaudited consolidated financial statements and notes thereto should be read in conjunction with the audited financial statements and notes thereto for the year ended December 31, 2000, contained in the Corporation's 2000 Annual Report to Stockholders.

#### Note 2 - Recently Issued Accounting Standards

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 141, *Business Combinations*. This Statement addresses financial accounting and reporting for business combinations and supersedes APB Opinion No. 16, *Business Combinations*, and FASB Statement No. 38, *Accounting for Preacquisition Contingencies of Purchased Enterprises*. All business combinations in the scope of this Statement are to be accounted for using one method, the purchase method. This Statement does not change many of the provisions of Opinion 16 and Statement 38 related to the application of the purchase method. The provisions of this Statement apply to all business combinations initiated after June 30, 2001. This Statement also applies to all business combinations accounted for using the purchase method for which the date of acquisition is July 1, 2001, or later.

In June 2001, the FASB also issued SFAS No. 142, *Goodwill and Other Intangible Assets*. This Statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, *Intangible Assets*. It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business

combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. The provisions of this Statement are required to be applied starting with fiscal years beginning after December 15, 2001. This Statement is required to be applied at the beginning of an entity's fiscal year and to be applied to all goodwill and other intangible assets recognized in its financial statements at that date. Impairment losses for goodwill and indefinite-lived intangible assets that arise due to the initial application of this Statement (resulting from a transitional impairment test) are to be reported as resulting from a change in accounting principle. Goodwill and intangible assets acquired after June 30, 2001, will be subject immediately to the nonamortization and amortization provisions of this Statement.

Based on its current activities, management does not expect these statements to have a material effect on the financial position, results of operations, or cash flows of the Corporation.

Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, was effective for all fiscal years beginning after June 15, 2000. SFAS 133, as amended, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities. Under SFAS 133, certain contracts that were not formerly considered derivatives may now meet the definition of a derivative. The Corporation adopted SFAS 133 effective January 1, 2001. The effect of such adoption did not impact the financial position, results of operations, or cash flows of the Corporation.

### Note 3 - Earnings per Share

The weighted average number of common shares used to calculate earnings per share for the periods ended September 30, 2001 and 2000 were as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2001	2000	2001	2000
Basic weighted - average shares	3,066,123	3,407,258	3,154,966	3,562,457
Effect of dilutive securities	<u>44,165</u>	<u>125</u>	<u>22,179</u>	<u>42</u>
Diluted weighted - average shares	3,110,288	3,407,383	3,177,145	3,562,499

### Note 4 - Declaration of Dividends

At their meeting on August 29, 2001, the Board of Directors declared an \$.11 (eleven cent) per share cash dividend on the common stock of the Corporation. The cash dividend was paid on September 25, 2001 to the stockholders of record at the close of business on September 11, 2001.

### Note 5 - Investment Securities

Investment securities consisted of the following (in thousands):

	September 30, 2001	
	Amortized Cost	Fair Value
<b>Held to Maturity</b>		
U. S. Government and Agency obligations	<u>\$133,039</u>	<u>\$134,414</u>

## Note 6 - Loans Receivable

Loans receivable consisted of the following (in thousands):

	<u>September 30, 2001</u>	<u>December 31, 2000</u>
First mortgage loans:		
One- to four- family residences	\$348,266	\$377,341
Other properties	45,939	41,751
Construction	25,072	24,937
Less:		
Unearned discounts	(199)	(191)
Undisbursed loan funds	(10,817)	(9,126)
Deferred loan fees, net	<u>(2,410)</u>	<u>(2,747)</u>
Total first mortgage loans	<u>405,851</u>	<u>431,965</u>
Consumer and other loans:		
Commercial	23,039	20,239
Automobile	18,120	16,051
Consumer	6,706	5,893
Home equity and second mortgage	24,435	19,797
Savings	1,556	2,042
Other	3,052	2,768
Add deferred loan costs	<u>258</u>	<u>241</u>
Total consumer and other loans	<u>77,166</u>	<u>67,031</u>
Allowance for loan losses	<u>(680)</u>	<u>(691)</u>
Loans receivable, net	<u>\$482,337</u>	<u>\$498,305</u>

Non-accrual loans at September 30, 2001 were \$2.3 million. All loans 90 days or more past due are recorded as non-accrual.

A summary of the activity in the allowance for loan losses is as follows (in thousands):

Balance at December 31, 2000	\$691
Provisions for estimated losses	163
Recoveries	13
Losses charged off	<u>(187)</u>
Balance at September 30, 2001	<u>\$ 680</u>

## **MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

### **Financial Condition**

At September 30, 2001, the Corporation's assets amounted to \$697.7 million as compared to \$713.9 million at December 31, 2000. The \$16.2 million or 2.3% decrease was primarily due to a decrease of \$51.3 million or 27.8% in investment securities-held to maturity and to a decrease of \$16.0 million or 3.2% in net loans receivable. Such decreases were partially offset by a \$37.7 million or 326.1% increase in cash and cash equivalents and a \$15.3 million increase in prepaid expenses and other assets. The increase in prepaid expenses and other assets was primarily due to the Bank's investment in bank owned life insurance which has a cash surrender value at September 30, 2001, of \$15.2 million. Loan originations for the nine month period ended September 30, 2001 consisted of \$82.5 million in one- to four- family residential loans, \$2.1 million in multi-family residential loans, \$16.8 million in commercial loans, \$22.7 million in construction loans and \$36.6 million in consumer installment loans, of which \$16.1 million consisted of home equity loans and \$12.1 million consisted of automobile loans. The decrease in net loans receivable was primarily due to customer refinancings in the lower rate environment and the sale by the Bank of such loans in the secondary mortgage market. At September 30, 2001, the Bank had outstanding loan commitments of \$6.8 million, unused lines of credit of \$8.6 million, and the undisbursed portion of construction loans of \$10.8 million. Liabilities decreased \$12.1 million or 1.9% to \$625.2 million at September 30, 2001 compared to \$637.3 million at December 31, 2000. The decrease in liabilities was primarily due to a decrease of \$37.5 million or 40.2% in advances from the Federal Home Loan Bank of Dallas ("FHLB of Dallas"). Such decrease was partially offset by a \$11.8 million or 2.2% increase in deposits and a \$13.9 million increase in other liabilities primarily due to \$13.4 million in commitments to purchase investment securities not yet settled in cash. Stockholders' equity amounted to \$72.4 million or 10.4% of total assets at September 30, 2001 compared to \$76.6 million or 10.7% of total assets at December 31, 2000. The decrease in stockholders' equity was primarily due to the purchase of 372,314 shares of treasury stock totaling \$7.8 million in connection with the Corporation's stock repurchase plan and to a lesser extent due to the payment of cash dividends aggregating \$1.1 million. Such decrease during the nine months ended September 30, 2001 was partially offset by net income of \$3.8 million resulting from continued profitable operations.

Non-performing assets, consisting of non-accruing loans and repossessed assets, amounted to \$2.7 million or .38% of total assets at September 30, 2001, compared to \$1.9 million or .27% of total assets at December 31, 2000. Such increase was primarily due to an increase in non-accruing loans collateralized by one-to-four family mortgage loans and consumer loans. The allowance for loan losses amounted to \$680,000 at September 30, 2001.

### **Results of Operations for the Three Months Ended September 30, 2001 and 2000**

**General.** The Corporation reported net income of \$1.6 million during the three months ended September 30, 2001 compared to net income of \$1.4 million for the same period in 2000. The

increase of \$231,000 in net income in the 2001 period compared to the same period in 2000 was primarily due to an increase in noninterest income. Net interest income rose slightly from \$4.6 million for the three months ended September 30, 2000 to \$4.7 million for the same period in 2001. Net interest income is determined by the Corporation's interest rate spread (i.e., the difference between the yields earned on its interest-earning assets and the rates paid on its interest-bearing liabilities) and the relative amounts of interest-earning assets and interest-bearing liabilities. The Corporation's interest rate spread and net interest margin increased to 2.48% and 2.86%, respectively, for the 2001 three month period compared to 2.19% and 2.67%, respectively, for the 2000 three month period. These and other significant fluctuations in operations are discussed below.

**Interest Income.** Interest income amounted to \$12.4 million for the three months ended September 30, 2001 compared to \$13.2 million for the same period in 2000. The decrease of \$806,000 or 6.1% was primarily due to a decrease in the average balance of investment securities and a decrease in the average yield earned on investment securities which was partially offset by an increase in the average balance of other interest earning assets, primarily overnight funds.

**Interest Expense.** Interest expense decreased \$879,000 or 10.2% to \$7.7 million for the three months ended September 30, 2001 compared to \$8.6 million for the same period in 2000. Such decrease was primarily due to a decline in the average balance of advances and a decrease in interest rates paid on deposits. Such decrease was partially offset by an increase in the average balance of deposits.

**Noninterest Income.** Noninterest income increased \$363,000 or 64.4% to \$927,000 for the three months ended September 30, 2001 compared to \$564,000 for the three months ended September 30, 2000. The increase in noninterest income for the three month comparable periods ended September 30 was primarily due to an increase of \$32,000 or 11.2% from \$280,000 to \$312,000 in deposit fee income, an increase of \$23,000 from \$23,000 to \$46,000 in loan related insurance commissions, an increase of \$158,000 from \$19,000 to \$177,000 in the gain on the sale of mortgage loans in the secondary mortgage market, an increase of \$27,000 from \$8,000 to \$35,000 in additional loan fees related to loan sales and an increase of \$149,000 in earnings from bank owned life insurance purchased in 2001.

**Noninterest Expense.** Noninterest expenses increased \$54,000 or 1.7% between the 2001 and 2000 three month periods ended September 30. Such increase was primarily due to an increase in data processing expenses. Data processing expense increased \$59,000 or 27.2% to \$276,000 for the three months ended September 30, 2001 compared to \$217,000 for the same period in 2000. Salaries and employee benefits amounted to \$1.9 million compared to \$2.0 million resulting in a decrease of \$107,000 or 5.3% for the three month periods ended September 30, 2001 and 2000, respectively.

**Income Taxes.** Income taxes amounted to \$727,000 and \$678,000 for the three months ended September 30, 2001 and 2000, respectively, resulting in effective tax rates of 31.02% and 32.8%, respectively.

## Results of Operations for the Nine Months Ended September 30, 2001 and 2000

**General.** The Corporation reported net income of \$3.8 million during the nine months ended September 30, 2001 compared to net income of \$4.4 million for the same period in 2000. The decrease of \$565,000 in net income in the 2001 period compared to the same period in 2000 was primarily due to a decrease in net interest income and an increase in noninterest expenses, which were offset by an increase in noninterest income and a decrease in income tax expense. Net interest income declined from \$14.4 million for the nine months ended September 30, 2000 to \$13.6 million for the same period in 2001. The Corporation's interest rate spread and net interest margin decreased to 2.27% and 2.72%, respectively, for the 2001 nine month period compared to 2.38% and 2.85%, respectively, for the 2000 nine month period.

**Interest Income.** Interest income amounted to \$38.7 million for the nine months ended September 30, 2000 compared to \$38.4 million for the same period in 2001. The decrease of \$290,000 was primarily due to a decrease in the average balance of and average yield earned on investment securities which were partially offset by an increase in the average balance of and average yield earned on net loans receivable and an increase in the average balance of other interest earning assets, primarily overnight funds.

**Interest Expense.** Interest expense increased \$460,000 or 1.9% to \$24.7 million for the nine months ended September 30, 2001 compared to \$24.3 million for the same period in 2000. Such increase was primarily due to an increase in the average balance of deposits, an increase in interest rates paid on such deposits, and an increase in the average interest rate paid on advances. Such increase was partially offset by a decline in the average balance of advances.

**Noninterest Income.** Noninterest income increased \$1.1 million or 75.5% to \$2.5 million for the nine months ended September 30, 2001 compared to \$1.4 million for the nine months ended September 30, 2000. The increase in noninterest income for the nine month comparable periods ended September 30 was primarily due to an increase of \$180,000 or 23.2% from \$775,000 to \$955,000 in deposit fee income, an increase of \$93,000 from \$49,000 to \$142,000 in loan related insurance commissions, an increase of \$390,000 from \$47,000 to \$437,000 in the gain on the sale of mortgage loans in the secondary mortgage market, an increase of \$77,000 from \$20,000 to \$97,000 in additional loan fees related to loan sales, and an increase of \$154,000 in earnings from bank owned life insurance purchased in 2001. The increase in noninterest income was also due to a decline in the net loss recognized from the operations of real estate owned in the amount of \$111,000. The property primarily incurring such losses was sold in June 2000.

**Noninterest Expense.** Noninterest expenses increased \$1.0 million or 11.3% between the 2001 and 2000 nine month periods ended September 30. The increase in noninterest expenses during the nine month period in 2001 compared to the same period in 2000 was primarily due to an increase in salaries and employee benefits and to a nonrecurring expense of \$352,000 for a death benefit payable pursuant to the employment contract of the Bank's Chief Executive Officer and Chairman of the Board at his death. Salaries and employee benefits, excluding the nonrecurring death benefit of \$352,000, amounted to \$6.2 million compared to \$5.9 million resulting in an

increase of \$332,000 or 5.7% for the nine month periods ended September 30, 2001 and 2000, respectively. Such increase in salaries and employee benefits was primarily due to an increase in personnel as well as salary and merit increases and an increase in the employee stock ownership plan expense as a result of the increase in the average corporation's stock price. Such increase was partially offset by a decline in management recognition and retention expense for the nine month comparable periods as a result of all shares previously granted becoming fully vested in May 2001.

**Income Taxes.** Income taxes amounted to \$1.8 million and \$2.2 million for the nine months ended September 30, 2001 and 2000, respectively, resulting in effective tax rates of 32.3% and 33.0%, respectively.

### **Liquidity and Capital Resources**

The Bank's liquidity, represented by cash and cash equivalents and eligible investment securities, is a product of its operating, investing and financing activities. The Bank's primary sources of funds are deposits, collections on outstanding loans, maturities and calls of investment securities and other short-term investments and funds provided from operations. While scheduled loan amortization and maturing investment securities and short-term investments are relatively predictable sources of funds, deposit flows and loan prepayments are greatly influenced by general interest rates, economic conditions and competition. The Bank manages the pricing of its deposits to maintain a steady deposit balance. In addition, the Bank invests excess funds in overnight deposits and other short-term interest-earning assets, which provide liquidity to meet lending requirements. The Bank has generally been able to generate enough cash through the retail deposit market, its traditional funding source, to offset the cash utilized in investing activities. As an additional source of funds, the Bank has borrowed from the FHLB of Dallas. At September 30, 2001, the Bank had outstanding advances from the FHLB of Dallas of \$55.8 million. Such advances were used in the Bank's normal operating and investing activities.

As of September 30, 2001, the Bank's regulatory capital was in excess of all applicable regulatory requirements. At September 30, 2001, the Bank's tangible, core and risk-based capital ratios amounted to 9.8%, 9.8% and 17.7%, respectively compared to applicable requirements of 1.5%, 4.0% and 8.0%, respectively.

### **Impact of Inflation and Changing Prices**

The financial statements and related financial data presented herein have been prepared in accordance with instructions to Form 10-Q, which require the measurement of financial position and operating results in terms of historical dollars, without considering changes in relative purchasing power over time due to inflation.

Unlike most industrial companies, virtually all of the Bank's assets and liabilities are monetary in nature. As a result, interest rates generally have a more significant impact on a financial institution's performance than does the effect of inflation.

## **Forward-Looking Statements**

This Form 10-Q contains certain forward-looking statements and information relating to the Corporation that are based on the beliefs of management as well as assumptions made by and information currently available to management. In addition, in those and other portions of this document, the words “anticipate,” “believe,” “estimate,” “except,” “intend,” “should” and similar expressions, or the negative thereof, as they relate to the Corporation or the Corporation’s management, are intended to identify forward-looking statements. Such statements reflect the current views of the Corporation with respect to future looking events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize or should underlying assumptions prove incorrect, actual results may vary from those described herein as anticipated, believed, estimated, expected or intended. The Corporation does not intend to update these forward-looking statements.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

For a discussion of the Corporation’s asset and liability management policies as well as the potential impact of interest rate changes upon the market value of the Bank’s portfolio equity, see "Management’s Discussion and Analysis of Financial Condition and Results of Operations" in the Corporation’s 2000 Annual Report to Stockholders. There has been no material change in the Corporation’s asset and liability position or the market value of the Bank’s portfolio equity since December 31, 2000.

**FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**

**Part II**

Item 1. Legal Proceedings

Neither the Corporation nor the Bank is involved in any pending legal proceedings other than non-material legal proceedings occurring in the ordinary course of business.

Item 2. Changes in Securities

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

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

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

None.

## **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.

### **FIRST FEDERAL BANCSHARES OF ARKANSAS, INC.**

Date: November 14, 2001

By: /s/Larry J. Brandt

Larry J. Brandt

President/CEO

Date: November 14, 2001

By: /s/Tommy W. Richardson

Tommy W. Richardson

Chief Financial Officer