TREX CO INC
Form 10-K
March 12, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

(Mark One)

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

For the fiscal year ended December 31, 2009

¨ **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: 001-14649

Trex Company, Inc.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**54-1910453** **(I.R.S. Employer Identification No.)**
160 Exeter Drive, Winchester, Virginia **(Address of principal executive offices)**	**22603-8605** **(Zip Code)**

(540) 542-6300

Registrant s telephone number, including area code:

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

Title of each class:	**Name of each exchange on which registered:**
Common Stock, par value $0.01 per share	**New York Stock Exchange**

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No þ

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 þ 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 posed pursuant to Rule 405 of Regulation S-T during the preceding 12 months. Yes ¨ No þ

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

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.

Large accelerated filer ¨	Accelerated filer þ
Non-accelerated filer ¨ (Do not check if a smaller reporting Company)	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 þ

The aggregate market value of the registrant s common equity held by non-affiliates of the registrant at June 30, 2009, which was the last business day of the registrant s most recently completed second fiscal quarter, was approximately $191.0 million based on the closing price of the common stock as reported on the New York Stock Exchange on such date and assuming, for purposes of this computation only, that the registrant s directors, executive officers and beneficial owners of 10% or more of the registrant s common stock are affiliates.

The number of shares of the registrant s common stock outstanding on March 9, 2010 was 15,452,256.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference in this Form 10-K as indicated herein:

Document	Part of 10-K into which incorporated
Proxy Statement relating to Registrant s 2010 Annual Meeting of Stockholders	Part III

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NOTE ON FORWARD-LOOKING STATEMENTS

This report, including the information it incorporates by reference, contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. We intend our forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding our expected financial position and operating results, our business strategy, our financing plans, forecasted demographic and economic trends relating to our industry and similar matters are forward-looking statements. These statements can sometimes be identified by our use of forward-looking words such as believe, may, will, anticipate, estimate, expect or intend. We cannot promise you that our expectations in such forward-looking statements will tu to be correct. Our actual results could be materially different from our expectations because of various factors, including the factors discussed under Risk Factors in this report.

PART I

Some of the information contained in this report concerning the markets and industry in which we operate is derived from publicly available information and from industry sources. Although we believe that this publicly available information and the information provided by these industry sources are reliable, we have not independently verified the accuracy of any of this information.

Item 1. Business

General

Trex Company, Inc., (the Company), founded as a Delaware corporation in 1999, is the largest U.S. manufacturer of wood-alternative decking, railing, fencing and trim products, which are marketed under the brand name Trex®. Our principal executive offices are located at 160 Exeter Drive, Winchester, Virginia 22603, and our telephone number at that address is (540) 542-6300.

Products

We offer a comprehensive set of aesthetically durable, low maintenance product offerings in the decking, railing, fencing and trim categories. We believe that the range and variety of our product offerings allow consumers to design much of their outdoor living space using Trex brand products.

The majority of our products are made in a proprietary process that combines waste wood fibers and reclaimed polyethylene. Our decking, railing, fencing and trim products are provided in a wide selection of popular sizes and lengths and are available with several finishes and/or numerous colors.

We market our decking products under seven brand names:

- Trex Accents®, which offers a smooth surface on one side and subtle wood grain on the other;
- Trex Accents Fire Defense®, which is a deck board that meets stringent new fire resistant requirements for certain areas of the Western United States;
- Trex Brasilia®, which replicates the look of tropical hardwoods with a smooth surface and subtle, random color variations;
- Trex Contours®, which has a deep, wood grain surface;
- Trex Escapes®, which is an ultra-low maintenance cellular PVC deck board;
- Trex Origins®, which features a smooth surface; and
- Trex Transcend™ , which features a protective shell for enhanced protection against fading, staining and scratching.

We also have Trex Hideaway®, which is a hidden fastening system for specially grooved boards.

Our two railing products are Trex Designer Series Railing® and Trex Transcend™ Railing. Our Designer Series Railing system consists of a decorative top and bottom rail, refined balusters, our Trex RailPost , and post caps and skirts. In addition to its styling benefits for consumers, this railing is fast and easy to construct for contractors that use our TrexExpress assembly tool and system. The Designer railing is available in our smooth Trex Origins finish and color palette, as well as in the Trex Brasilia finish and colors. Trex Transcend Railing is available in a white

finish that makes it appropriate for use with Trex decking products as well as other decking materials, which we believe will enhance the sales prospects of our railing business, and in the colors of Trex Transcend decking. This railing product is manufactured with Fibrex® material, which is a patented technology that we license from Andersen Corporation.

We offer two fencing products. Each product consists of structural posts, bottom rail, pickets, top rail and decorative post caps. The Trex Seclusions® fencing product uses interlocking pickets for privacy, and the Trex Surroundings® fencing uses traditional pickets. These systems have been well received by fencing installers and provide the homeowner a superior combination of low maintenance, durability and premium aesthetics which are designed to complement the outdoor living experience provided by Trex decking and railing products.

Our TrexTrim product is a low maintenance cellular PVC residential exterior trim product that offers exceptional workability, durability, visual appeal and a low level of required maintenance.

Trex products offer a number of significant aesthetic advantages over wood while eliminating many of wood s major functional disadvantages, which include warping, splitting and other damage from moisture. Our products require no staining, are resistant to moisture damage, provide a splinter-free surface and need no chemical treatment against rot or insect infestation. These features eliminate most of the on-going maintenance requirements for a wood deck and make Trex products less costly than wood over the life of the deck. Like wood, Trex products are slip-resistant (even when wet), can be painted or stained and are less vulnerable to damage from ultraviolet rays. Special characteristics (including resistance to splitting, the ability to bend, and ease and consistency of machining and finishing) facilitate deck, railing, fencing and trim installation, reduce contractor call-backs and afford customers a wide range of design options. Trex products do not have the tensile strength of wood and, as a result, are not used as primary structural members in posts, beams or columns used in a deck s substructure.

We have received product building code listings from the major U.S. and Canadian building code listing agencies for both our decking and railing systems. Our listings facilitate the acquisition of building permits by deck builders and promote consumer and industry acceptance of our products as an alternative to wood in decking. In addition, Trex Seclusions privacy fencing has passed the Miami/Dade County wind load testing, a widely regarded standard for assessing a fencing product s performance under extreme environmental conditions.

Growth Strategies

Our long-term goal is to perpetuate our position as the leading producer of branded superior wood-alternative outdoor living products by increasing our market share and expanding into new product categories and geographic markets. To attain this goal, we intend to employ the following long-term strategies:

Innovation: Bring to the market new products that address unmet consumer and trade professional needs. Provide a compelling value proposition through ease of installation, low maintenance, long-term durability and superior aesthetics.

Brand: Continue to build preference and commitment for the Trex brand with both the consumer and trade professional. Deliver on the brand s promise of superior quality, functionality, aesthetics and overall performance in the outdoor living space.

Channels: Achieve comprehensive market segment and geographic coverage for Trex products by increasing the number of stocking dealers and retailers, thereby making our products available wherever our customers choose to purchase their decking, railing, and fencing and trim products.

Quality: Continuously advance the quality of all operational and business processes, with the goal of achieving superior product quality and service levels, thereby giving our Company a sustainable competitive advantage.

Cost: Through capital investments and process engineering, continuously seek to lower the cost to manufacture Trex products. Investments in plastic recycling capabilities will allow us to expand our ability to use a wider breadth of waste streams and, as a result, lower our raw material costs. We plan to concentrate on improving the productivity of our production process, from raw materials preparation through extrusion into finishing and packaging.

Customers and Distribution

We distribute and/or sell our products through wholesale distribution and sell our products primarily to retail lumber dealers, retail building material specialty builders, Home Depot and Lowe s.

Wholesale Distributors. In 2009, we generated the majority of our net sales through our wholesale distribution network by selling Trex products to wholesale companies. Our distributors, in turn, marketed our products to retail lumber outlets across North America. Although our dealers sell to both homeowners and contractors, they primarily direct their sales at professional contractors, remodelers and homebuilders.

We believe that attracting wholesale distributors, who are committed to our products and marketing approach and can effectively sell higher value products to contractor-oriented lumber yards and other retail outlets, is important to our future growth. Our distributors are able to provide value-added service in marketing our products because they sell premium wood decking products and other innovative building materials that typically require product training and personal selling efforts.

We typically appoint a distributor on a non-exclusive basis to distribute Trex products within a specified area. The distributor generally purchases our products at prices in effect at the time we ship the product to the distributor.

Based on our 2009 gross sales, sales to two of our distributors, Boise Cascade Corporation and Capital Lumber, exceeded 10% of our gross sales.

Retail Lumber Dealers. Our products are sold in independent lumber yards that emphasize sales to contractors. Although there is demand for our products from both the do-it-yourself homeowner and contractor, our sales efforts historically have emphasized the contractor-installed market. Contractor-installed decks generally are larger installations with professional craftsmanship. Our retail dealers generally provide sales personnel trained in Trex products, contractor training, inventory commitment and point-of-sale display support.

Retail Building Material Specialty Dealers. Composite decking is increasingly being sold through dealers that specialize in specific product lines instead of general lumber sales. These dealers include roofing and siding supply companies. We are focusing more attention on these distribution channels as we seek to make our products available at any retail location where contractor, builder or homeowner customers choose to purchase their decking.

Home Depot and Lowe s. We sell our products through Home Depot and Lowe s stores. Although Home Depot and Lowe s serve the contractor market, the largest part of their sales are to do-it-yourself homeowner customers that shop for their materials at Home Depot and Lowe s stores rather than at retail lumber dealers. We believe that brand exposure through Home Depot and Lowe s distribution promotes consumer acceptance and generates sales to contractors that purchase from independent dealers.

Manufacturing Process

We have manufacturing facilities in Winchester, Virginia and Fernley, Nevada, which had floor space of approximately 265,000 square feet and 250,000 square feet, respectively, at December 31, 2009. In September 2007, we suspended operations at our Olive Branch facility and consolidated all of our manufacturing operations into our Winchester and Fernley sites. Our manufacturing capacity utilization rate was 32%, excluding the Olive Branch facility, during the year ended December 31, 2009.

Trex products are primarily manufactured from waste wood fiber and reclaimed polyethylene, which we sometimes refer to as PE material in this report. Our primary manufacturing process involves mixing wood particles with plastic, heating and finally extruding, or forcing, the highly viscous and abrasive material through a profile die. We have many proprietary and skill-based advantages in this process.

Production of a non-wood decking alternative such as ours requires significant capital investment, special process expertise and time to develop. We have continuously invested the capital necessary to expand our manufacturing capacity and improve our manufacturing processes. We have obtained, and continue to seek, patents with respect to our manufacturing process. We have also broadened the range of raw materials that we can use to produce a consistent and high-quality finished product. We maintain research and development operations in the Trex Technical Center adjacent to our Winchester, Virginia manufacturing facilities. In connection with our building code listings, we maintain a quality control testing program that is monitored by an independent inspection agency.

In 2005, we initiated Company-wide training and implementation of Six Sigma practices and in 2006 began implementation of Standard Lean Manufacturing methodology within our plant operations. These initiatives were significantly reenergized and expanded in 2008 and 2009. We are incorporating the use of these tools throughout our Company in the planning and execution of those projects that are the most important to our success.

Suppliers

The production of most of our products requires the supply of waste wood fiber and PE material.

The Company fulfills requirements for raw materials under both purchase orders and supply contracts. In the year ended December 31, 2009, the Company purchased substantially all of its waste wood fiber requirements under purchase orders, which do not involve long-term supply commitments. Substantially all of the Company s PE material purchases are under short-term supply contracts that average two years, for which pricing is negotiated as needed. The PE material supply contracts have not had a material adverse effect on the Company s business.

Waste Wood Fiber. Woodworking plants or mills are our preferred suppliers of waste wood fiber because the waste wood fiber produced by these operations contains little contamination and is low in moisture. These facilities generate waste wood fiber as a byproduct of their manufacturing operations.

If the waste wood fiber meets our specifications, our waste wood fiber supply contracts generally require us to purchase at least a specified minimum and at most a specified maximum amount of waste wood fiber each year. Depending on our needs, the amount of waste wood fiber that we actually purchase within the specified range under any supply contract may vary significantly from year to year.

PE Material. The PE material we consumed in 2009 was primarily composed of recovered plastic bags and plastic film. Approximately two billion pounds of polyethylene resin are used in the manufacture of plastic bags and stretch film in the United States each year. We will continue to seek to meet our future needs for plastic from the expansion of our existing supply sources and the development of new sources, including post-industrial waste and plastic coatings. We believe our use of multiple sources provides us with a cost advantage and facilitates an environmentally responsible approach to our procurement of PE material.

Our ability to source and use a wide variety of PE material is important to our cost strategy. We maintain this ability through the continued expansion of our plastic reprocessing operations in combination with the advancement of our proprietary material preparation and extrusion processes.

We own a 35% equity interest in a joint venture, called Denplax S.A., which operates a plant in El Ejido, Spain. Our joint venture partners are a local Spanish Company responsible for public environmental programs in southern Spain and an Italian equipment manufacturer. The plant is designed to recycle waste polyethylene generated primarily from agricultural and post-consumer sources. The plant delivered approximately 12% of the total PE material we purchased during 2009.

Third-Party Manufacturing. The Company outsources the production of certain products to third-party manufacturers under supply contracts that commit the Company to purchase minimum levels for each year extending through 2011. The Company is subject to monetary penalties if it fails to purchase a minimum volume as specified in the contracts.

Competition

In decking, we compete with wood and other manufacturers of wood alternative decking products. Many of the conventional lumber suppliers with which we compete have established ties to the building and construction industry and have well-accepted products. In railing, we compete with wood and other manufacturers of composite, non-wood and plastic products, as well as with railings using metal, glass, vinyl and other materials. In privacy fencing, we compete with wood, vinyl and other manufacturers of composites. In trim, we compete against wood, engineered wood, fiber cement, and other manufacturers of cellular PVC and similar plastic products.

Our primary competition consists of wood products, which constituted a substantial majority of 2009 decking and railing sales, as measured by linear feet of lumber. A majority of the lumber used in wooden decks is pressure-treated lumber. Southern yellow pine and fir have a porosity that readily allows the chemicals used in the pressure treating process to be absorbed. The same porosity makes southern yellow pine susceptible to taking on moisture, which causes the lumber to warp, crack, splinter and expel fasteners. In addition to pine and fir, other segments of wood material for decking include redwood, cedar and tropical hardwoods, such as ipe, teak and mahogany. These products are often significantly more expensive than pressure-treated lumber, but do not eliminate many of the disadvantages of other wood products.

Industry studies indicate that we have the leading market share of the wood/plastic composite segment of the decking and railing market. Our principal competitors in the wood/plastic composite decking and railing market include Advanced Environmental Recycling Technologies, Inc., Fiber Composites, LLC, Tamko Building Products, Inc., Timbertech Limited, and Universal Forest Products, Inc.

We also compete with decking products made from 100% plastic lumber that utilizes polyethylene, fiberglass and PVC as raw materials. Although there are several companies in the United States that manufacture 100% plastic lumber, this segment accounted for only a very small percentage of 2009 decking sales. We believe a number of factors have limited the success of 100% plastic lumber manufacturers, including poor product aesthetics and physical properties not considered suitable for decking, such as higher thermal expansion and contraction and poor slip resistance. We believe that Trex Escapes, an ultra-low maintenance cellular PVC deck board, is superior, both in terms of product aesthetics and physical properties, to 100% plastic lumber products available in the market.

Our ability to compete depends, in part, on a number of factors outside our control, including the ability of our competitors to develop new non-wood decking and railing alternatives that are competitive with our products. We believe that the principal competitive factors in the decking and railing market include product quality, price, aesthetics, maintenance cost, distribution and brand strength. We believe we compete favorably with respect to these factors. We believe that our products offer aesthetic and cost advantages over the life of a deck when compared to other types of decking and railing materials. Although a contractor-installed deck built with Trex products in 2009 using a pressure-treated wood substructure generally costs more than a deck made entirely from pressure-treated wood, Trex products eliminate most of the on-going maintenance required for a pressure-treated deck and are, therefore, less costly over the life of the deck. We believe that our manufacturing process and utilization of relatively low-cost raw material sources provide us with a competitive cost advantage relative to other wood/plastic composite and 100% plastic decking products. The scale of our operations also confers cost efficiencies in manufacturing, sales and marketing.

Government Regulation

We are subject to federal, state and local environmental regulation. The emissions of particulates and other substances from our manufacturing facilities must meet federal and state air quality standards implemented through air permits issued to us by the Department of Environmental Quality of the Commonwealth of Virginia, the Division of Environmental Protection of Nevada s Department of Conservation and Natural Resources and the Mississippi Department of Environmental Quality. Our facilities are regulated by federal and state laws governing the disposal of solid waste and by state and local permits and requirements with respect to wastewater and storm water discharge. Compliance with environmental laws and regulations has not had a material adverse effect on our business, operating results or financial condition.

Our operations also are subject to work place safety regulation by the U.S. Occupational Safety and Health Administration, the Commonwealth of Virginia, the State of Nevada and the State of Mississippi. Our compliance efforts include safety awareness and training programs for our production and maintenance employees.

Intellectual Property

Our success depends, in part, upon our intellectual property rights relating to our products, production processes and other operations. We rely upon a combination of trade secret, nondisclosure and other contractual arrangements, and patent, copyright and trademark laws, to protect our proprietary rights. We have made substantial investments in manufacturing process improvements that have enabled us to increase manufacturing line production rates, facilitated our development of new products, and produced improvements in our existing products dimensional consistency, surface texture and color uniformity.

Intellectual property rights may be challenged by third parties and may not exclude competitors from using the same or similar technologies, brands or works. We seek to secure effective rights for our intellectual property, but cannot provide assurance that third parties will not successfully challenge, or avoid infringing, our intellectual property rights.

We have obtained two patents for complementary methods of preparing the raw materials for the manufacturing phase of production, one patent on an apparatus for implementing one of the methods, and one patent on a tool for use with the installation of the decking board. We intend to maintain our existing patents in effect until they expire, beginning in 2015, as well as to seek additional patents as we consider appropriate.

We consider our trademarks to be of material importance to our business plans. The U.S. Patent and Trademark Office has granted us federal registrations for many of our trademarks. Federal registration of trademarks is effective for as long as we continue to use the trademarks and renew their registrations. We do not generally register any of our copyrights with the U.S. Copyright Office, but rely on the protection afforded to such copyrights by the U.S. Copyright Act. This law provides protection to authors of original works, whether published or unpublished, and whether registered or unregistered. We enter into confidentiality agreements with our employees and limit access to and distribution of our proprietary information. If it is necessary to disclose proprietary information to third parties for business reasons, we require that such third parties sign a confidentiality agreement prior to any disclosure.

See Legal Proceedings in Item 3 of this report for information about a lawsuit involving intellectual property to which we were a party.

Employees

At December 31, 2009, we had approximately 520 full-time employees, approximately 375 of whom were employed in our manufacturing operations. Our employees are not covered by collective bargaining agreements. We believe that our relationships with our employees are good.

Web Sites and Additional Information

The SEC maintains an Internet web site at *www.sec.gov* that contains reports, proxy statements, and other information regarding our Company. In addition, we maintain an Internet corporate web site at *www.trex.com*. We make available through our web site our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports, as soon as reasonably practicable after we electronically file or furnish such material with or to the SEC. We do not charge any fees to view, print or access these reports on our web site. The contents of our web site are not a part of this report.

Executive Officers and Directors

The table below sets forth information concerning our executive officers and directors as of February 15, 2010.

Name	Age	Positions with Company
Ronald W. Kaplan	58	President and Chief Executive Officer; Director
James E. Cline	58	Vice President and Chief Financial Officer
J.Mitchell Cox	51	Vice President, Sales
William R. Gupp	50	Chief Administrative Officer, General Counsel and Secretary
F. Timothy Reese	57	Vice President, Operations
Andrew U. Ferrari	63	Chairman
William F. Andrews	78	Director
Paul A. Brunner	74	Director
Jay M. Gratz	57	Director
Frank H. Merlotti, Jr.	59	Director
Richard E. Posey	63	Director
Patricia B. Robinson	57	Director

Ronald W. Kaplan has served as a director and President and Chief Executive Officer of the Company since January 2008. From February 2006 through December 2007, Mr. Kaplan served as Chief Executive Officer of Continental Global Group, Inc., a manufacturer of bulk material handling systems. From July 2005 to February 2006, Mr. Kaplan was an independent consultant. From 1979 to July 2005, Mr. Kaplan was employed by Harsco Corporation, an international industrial services and products company, at which he served in a number of capacities, including as Senior Vice President-Operations, and, from 1994 through June 2005, as President of Harsco s Gas Technologies Group, which manufactures containment and control equipment for the global gas industry. Mr. Kaplan received a B.A. degree in economics from Alfred University and an M.B.A. degree from the Wharton School of Business, University of Pennsylvania.

James E. Cline has served as Vice President and Chief Financial Officer of the Company since March 2008. Mr. Cline served from July 2005 through December 2007 as the President of Harsco GasServ, a subsidiary of Harsco Corporation and a manufacturer of containment and control equipment for the global gas industry. From January 2008 through February 2008, in connection with the purchase of Harsco GasServ by Taylor-Wharton International LLC, which is owned by Windpoint Partners Company, Mr. Cline served as a consultant to the buyers by providing transition management and financial services. From April 1994 through June 2005, Mr. Cline served as the Vice President and Controller of Harsco GasServ. Mr. Cline served in various capacities with Huffy Corporation from June 1976 to February 1994, including as the Director of Finance of its True Temper Hardware subsidiary, a manufacturer of lawn care and construction products with nine manufacturing locations in the United States, Canada and Ireland. Mr. Cline received a B.S.B.A. degree in accounting from Bowling Green State University.

J. Mitchell Cox has served as Vice President, Sales of the Company since September 2005. From 1981 to August 2005, Mr. Cox was employed by Kraft Foods Inc., an international manufacturer of packaged food and

beverage products, at which he served in a number of capacities, including Region Vice President from 1996 to August 2005; Director of Category Management from 1994 to 1996; and Division Sales Manager Metro New York/New Jersey from 1992 to 1994. Mr. Cox received a B.A. degree in English from the University of North Carolina at Chapel Hill.

William R. Gupp has served as Chief Administrative Officer, General Counsel and Secretary of the Company since October 2009. From May 2001 to October 2009, Mr. Gupp served as Vice President and General Counsel of the Company. From March 1993 to May 2001, Mr. Gupp was employed by Harsco Corporation, an international industrial services and products Company, most recently as Senior Counsel and Director-Corporate Development. From August 1985 to March 1993, Mr. Gupp was employed by the law firm of Harter, Secrest & Emery. Mr. Gupp received a B.S. degree in accounting from Syracuse University and a J.D. from the University of Pennsylvania Law School.

F. Timothy Reese has served as Vice President, Operations of the Company since February 2008. From March 2007 through January 2008, Mr. Reese served as Operations Director for the Americas Region of DuPont Teijin Films, a DuPont Teijin Films U.S. Limited Partnership and producer of polyester films. From 1979 to March 2007, Mr. Reese served in various positions with DuPont, including Global Director, Business and Integrated Operations, DuPont High Performance Films, from November 1995 through November 1998; Director/Plant Manager, Global Operations, Cyrel® Packaging Graphics Products, from December 1998 through May 2000; Director, Global Operations and Six Sigma Champion, Cyrel® Packaging Graphics Products, from June 2000 through February 2001; and Director/Plant Manager in multiple assignments from March 2001 through February 2007, including in Corporate Operations, Human Resources and DuPont Chemical Solutions Enterprise. Mr. Reese served in the U.S. Navy and received a B.S. in ocean engineering with an emphasis on mechanical engineering from the U.S. Naval Academy.

Andrew U. Ferrari has served as a director of the Company since September 1998 and as Chairman since January 2008. Mr. Ferrari served as Chief Executive Officer of the Company from August 2007 through December 2007, and as President and Chief Operating Officer of the Company from August 2005 through July 2007. From March 2003 through August 2005, Mr. Ferrari was a marketing and business development consultant. Mr. Ferrari served as Executive Vice President of Marketing and Business Development of the Company from October 2001 through March 2003, and of TREX Company, LLC, which was the Company s wholly-owned subsidiary until December 31, 2002, from October 2001 through December 2002. He served as Executive Vice President of Sales and Marketing of the Company from September 1998 to October 2001 and of TREX Company, LLC from August 1996 to October 2001. From 1989 to 1996, Mr. Ferrari held various positions with Mobil Chemical, including Director of Sales and Marketing of the Composite Products Division, New Business Manager, and Marketing Director of the Consumer Products Division. Mr. Ferrari received a B.A. degree in economics from Whitman College and an M.B.A. degree from Columbia University.

William F. Andrews has served as a director of the Company since April 1999. Mr. Andrews has served as Chairman of Katy Industries, Inc., a manufacturer of maintenance and electrical products, since October 2001, and as Chairman of the Singer Sewing Company, a manufacturer of sewing machines, since 2004. Mr. Andrews served as Chairman of Corrections Corporation of America from 2000 to 2008 and is now the Chairman of the Executive Committee of the Board. Mr. Andrews has been a Principal of Kohlberg & Company, a venture capital firm, since 1994, and served as Chairman of Allied Aerospace Company from 2000 to 2006. Prior to 2002, he served in various positions, including Chairman of Scovill Fasteners Inc.; Chairman of Northwestern Steel and Wire Company; Chairman of Schrader-Bridgeport International, Inc.; Chairman, President and Chief Executive Officer of Scovill Manufacturing Co., where he worked for over 28 years; Chairman and Chief Executive Officer of Amdura Corporation; Chairman of Utica Corporation; and Chairman, President and Chief Executive Officer of Singer Sewing Company. Mr. Andrews also serves as a director of Black Box Corporation and O Charley s Restaurants. Mr. Andrews received a B.S. degree in business administration from the University of Maryland and an M.B.A degree in marketing from Seton Hall University.

Paul A. Brunner has served as a director of the Company since February 2003. Mr. Brunner is President and Chief Executive Officer of Spring Capital Inc., a merchant bank, which he founded in 1985. From 1982 to 1985, Mr. Brunner served as President and Chief Executive Officer of U.S. Operations of Asea-Brown Boveri, a multi-national Swiss manufacturer of high technology products. In 1967, he joined Crouse Hinds Company, a manufacturer of electronics and electronic equipment, and through 1982 held various positions with that company, including President and Chief Operating Officer, Executive Vice President of Operations, Vice President of Finance and Treasurer, and Director of Mergers and Acquisitions. Mr. Brunner served as a director of Johnson Controls, Inc. from 1983 through 2007, and as Chairman of its Audit Committee from 1989 to 2005. From 1959 to 1967, he worked for Coopers & Lybrand, an international accounting firm, as an audit supervisor. Mr. Brunner is a Certified Public Accountant. He received a B.S. degree in accounting from the University of Buenos Aires and an M.B.A. degree in management from Syracuse University.

Jay M. Gratz has served as a director of the Company since February 2007. Mr. Gratz has been a partner in Tatum LLC, a national executive services and consulting firm that focuses on the needs of the Office of the CFO since February 2010. From October 2007 through February 2010, Mr. Gratz was an independent consultant. From 1999 through October 2007, Mr. Gratz served as Executive Vice President and Chief Financial Officer of Ryerson Inc., a metals processor and distributor, and as President of Ryerson Coil Processing Division from November 2001 through October 2007. Mr. Gratz served as Vice President and Chief Financial Officer of Inland Steel Industries from 1994 through 1998 and served in various other positions, including Vice President of Finance, at that company since 1975. Mr. Gratz is a Certified Public Accountant. He received a B.A. degree in economics from the State University of New York in Buffalo and an M.B.A. degree from Northwestern University Kellogg Graduate School of Management.

Frank H. Merlotti, Jr. has served as a director of the Company since February 2006. Since October 2006, Mr. Merlotti has served as President of Steelcase Design Group, the North American business unit of Steelcase, Inc., a manufacturer of office furniture and furniture systems, and served as President of Steelcase North America from September 2002 through September 2006. Mr. Merlotti served as President and Chief Executive Officer of G&T Industries, a manufacturer and distributor of fabricated foam and soft-surface materials for the marine, office furniture and commercial building industries, from August 1999 to September 2002. From 1991 through 1999, Mr. Merlotti served as President and Chief Executive Officer of Metropolitan Furniture Company, a Steelcase Design Partnership Company. From 1985 through 1999, Mr. Merlotti served as General Manager of the Business Furniture Division of G&T Industries.

Richard E. Posey has served as a director of the company since May 2009. He served as President and Chief Executive Officer of Moen Incorporated, a leading manufacturer in the global faucet market, for six years before retiring in 2007. Prior to joining Moen, Mr. Posey was President and Chief Executive Officer of Hamilton Beach / Proctor Silex, Inc. for five years. Mr. Posey began his career at S.C. Johnson & Son, where for 22 years he served in a series of increasingly responsible management positions, both overseas and in the U.S., culminating with Executive Vice President, Consumer Products, North America. Mr. Posey currently serves on the Board of Directors of The Colman Group, a supply equipment company, is a member of the Visiting Committee, The Ross School of Business, The University of Michigan, and is a Founding Trustee, Virginia Commonwealth University School of Engineering Foundation. He received a B.A. degree in English from The University of Southern California and an M.B.A. degree from The University of Michigan.

Patricia B. Robinson has served as a director of the Company since November 2000. Ms. Robinson has been an independent consultant since 1999. From 1977 to 1998, Ms. Robinson served in a variety of positions with Mead Corporation, a forest products company, including President of Mead School and Office Products, Vice President of Corporate Strategy and Planning, President of Gilbert Paper, Plant Manager of a specialty machinery facility and Product Manager for new packaging product introductions. Ms. Robinson received a B.A. degree in economics from Duke University and an M.B.A. degree from the Darden School at the University of Virginia.

Item 1A. Risk Factors

Our business is subject to a number of risks, including the following:

We may not be able to grow unless we increase market acceptance of our products and develop new products and applications.

Our primary competition consists of wood products, which constitute a substantial majority of decking and railing sales. Our ability to grow will depend largely on our success in converting the current demand for wood in decking, railing, fencing, and trim applications into a demand for Trex products. To increase our market share, we must overcome:

- the consumer lack of awareness of the value of non-wood decking, railing, fencing and trim alternatives in general and Trex brand products in particular;
- the resistance of many consumers and contractors to change from well-established wood products;
- the greater initial expense of Trex decking, railing, fencing and trim compared to wood;
- the established relationships existing between suppliers of wood decking, railing, fencing and trim products and contractors and homebuilders; and
- the competition from other wood alternative manufacturers.

In addition to the above, substantially all of our revenues are derived from sales of our proprietary wood/plastic composite material. Although we have developed, and continue to develop, new products made from other materials, if we should experience significant problems, real or perceived, with product quality or acceptance of the Trex wood/polyethylene composite material, our lack of product diversification could have a significant adverse impact on our net sales levels.

Our prospects for sales growth and profitability may be adversely affected if we fail to maintain product quality and product performance at an acceptable cost.

We will be able to expand our net sales and to sustain and enhance profitable operations only if we succeed in maintaining the quality and performance of our products. If we should not be able to produce high-quality products at standard manufacturing rates and yields, unit costs may be higher. A lack of product performance would negatively affect our profitability by impeding acceptance of our products in the marketplace and by leading to higher product replacement and consumer relations expenses. In recent periods, we have experienced significant increases in product replacement and consumer relations expenses related to a small portion of our production at our Fernley, Nevada manufacturing facility and have increased our warranty reserve accordingly. Because the establishment of reserves is an inherently uncertain process involving estimates of the number of future claims and the cost to settle claims, our ultimate losses may exceed our warranty reserve. Future increases to the warranty reserve would have an adverse effect on our profitability in the periods in which we make such increases. Increases we made to the warranty reserve in 2007 had a material adverse effect on 2007 profitability and payments for related claims had a material adverse effect on our cash flow in 2007, 2008 and 2009.

Our sales and reputation may be affected by product liability claims or litigation in relation to our products.

Our products are used outdoors and are sometimes subject to heavy use and harsh exposure to the environment. Although our Limited Warranty excludes any conditions attributable to any act of God (such as flooding, hurricane, earthquake, lighting, etc.,), environmental condition (such as air pollution, mold, mildew, etc.), staining from foreign substances (such as dirt, grease, oil, etc.), or normal weathering (defined as exposure to sunlight, weather and atmosphere which will cause any colored surface to gradually fade, chalk, or accumulate dirt or stains), to the extent that our products are affected in any way, this may lead to an increased risk of product liability claims or litigation. Such claims could cause adverse publicity which in turn could result in a

loss of consumer confidence in our products and also reduce our sales. Product liability claims could increase our expenses and have a material adverse effect on demand for our products and, consequently, reduce our sales, net income and liquidity.

Our business is subject to risks in obtaining the raw materials we use at acceptable prices.

The production of our product requires substantial amounts of wood fiber and PE material. Our business strategy is to create a substantial cost advantage over our competitors by using recycled plastic and reclaimed wood. Our business could suffer from the termination of significant sources of raw materials, the payment of higher prices for raw materials or the failure to obtain sufficient additional raw materials to meet planned increases in production. Our ability to obtain adequate supplies of PE material depends on our success in developing new sources that meet our quality requirements, entering into long-term arrangements with suppliers and managing the collection of supplies from geographically dispersed distribution centers and off-shore sources.

The demand for our products is influenced by general economic conditions and could be adversely affected by economic downturns.

The demand for our products is correlated to changes in the health of the economy in general, and the level of activity in home improvements and, to a much lesser extent, new home construction. These activity levels, in turn, are affected by such factors as home equity values, consumer spending habits, employment, interest rates and inflation. Market conditions in the housing industry have slowed significantly in recent periods, particularly in new home construction. Home equity values in many markets have decreased significantly, adversely affecting the availability of home equity withdrawals, which have resulted in decreased home improvement spending. In 2008, the U.S. economy entered into a recession. We cannot predict how long the recession will last and whether the downward trend in home remodeling and new home construction will continue or worsen. Any continued economic downturn could reduce consumer income or equity capital available for spending on discretionary items such as decking, railing, fencing or trim, which could adversely affect the demand for our products.

Our performance may suffer if we do not compete effectively in the highly competitive decking, railing, fencing and trim markets.

We must compete with an increasing number of companies in the wood/plastic composites segment of the decking, railing, fencing and trim markets and with wood producers that currently have more production capacity than is required to meet the demand for such products. Our failure to compete successfully in such markets could have a material adverse effect on our ability to replace wood or increase the market share of wood/plastic composites compared to wood. Many of the conventional lumber suppliers with which we compete have established ties to the building and construction industry and have well-accepted products. Many of our competitors in the decking, railing, fencing and trim markets that sell wood products have significantly greater financial, technical and marketing resources than we do. Our ability to compete depends, in part, upon a number of factors outside our control, including the ability of competitors to develop new non-wood alternatives that are more competitive with Trex products.

We have significant capital invested in property, plant and equipment that may become obsolete or impaired and result in a charge to our earnings.

At December 31, 2009, we had $137.0 million of net property, plant and equipment. The improvement we seek to make to our manufacturing processes sometimes involves the implementation of new technology and replacement of equipment at our manufacturing facilities, which may result in charges to our earnings if the existing equipment is not fully depreciated. Of our net property, plant and equipment at December 31, 2009, approximately $14.2 million is located at our Olive Branch, Mississippi manufacturing facility. In September 2007, we suspended operations at our Olive Branch facility and consolidated all of our manufacturing operations into our Winchester and Fernley sites. In September 2009, we recorded a pre-tax impairment charge

of $23.3 million related to the long-lived assets held at the facility. Changes in the expected cash flows related to our facilities in the future may result in additional impairment charges and reduced earnings.

Our level of indebtedness could adversely affect our financial health and ability to compete.

As of December 31, 2009, we had $101.0 million of total indebtedness. Our level of indebtedness could have important consequences. For example, it may:

- increase our vulnerability to general adverse economic and industry conditions, including interest rate fluctuations;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our ability to borrow additional funds to alleviate liquidity constraints, as a result of financial and other restrictive covenants in our indebtedness;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- place us at a competitive disadvantage relative to companies that have less indebtedness; and
- limit our ability to refinance our principal secured indebtedness.

In addition, our senior secured credit facility imposes operating and financial restrictions that may limit our discretion on some business matters, which could make it more difficult for us to expand, finance our operations and engage in other business activities that may be in our interest. These restrictions may limit our ability to:

- incur additional indebtedness and additional liens on our assets;
- engage in mergers or acquisitions or dispose of assets;
- enter into sale-leaseback transactions;
- pay dividends or make other distributions;
- voluntarily prepay other indebtedness;
- enter into transactions with affiliated persons;
- make investments; and

change the nature of our business.

We may incur indebtedness in addition to our current indebtedness. Any additional indebtedness we may incur in the future could subject us to similar or even more restrictive conditions.

Our ability to refinance our indebtedness will depend on our ability in the future to generate cash flows from operations and to raise additional funds, including through the offering of equity or debt securities. We may not be able to generate sufficient cash flows from operations or to raise additional funds in amounts necessary for us to repay our indebtedness when such indebtedness becomes due and to meet our other cash needs.

Our ability to make scheduled principal and interest payments on our real estate loans, convertible notes, borrow and repay amounts under our revolving credit facility and continue to comply with our loan covenants will depend primarily on our ability to generate sufficient cash flow from operations. Our failure to comply with our loan covenants might cause our lenders to accelerate our repayment obligations under our credit facility, which may be declared payable immediately based on a default and which could result in a cross-default under our $97.5 million principal amount of outstanding convertible notes. Our ability to borrow under our revolving

credit facility is tied to a borrowing base that consists of specified receivables and inventory. To remain in compliance with our credit facility, and real estate loans, we must maintain specified financial ratios based on our levels of debt, capital, net worth, fixed charges, and earnings (excluding extraordinary gains and extraordinary non-cash losses) before interest, taxes, depreciation and amortization, all of which are subject to the risks of our business.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We lease our corporate headquarters in Winchester, Virginia, which consists of 32,517 square feet of office space, under a lease that expires in March 2020. In anticipation of relocating our corporate headquarters to Dulles, Virginia, we entered into a lease agreement in 2005, which expires in 2019. The Dulles lease agreement provides for our initial occupancy of 55,047 square feet of office space, which will increase during the lease term to 80,071 square feet in mid-2012. We reconsidered our decision to relocate our corporate headquarters in 2005 and decided not to move. As of January 10, 2008, we had executed subleases for the entire space we currently lease. The terms of the existing subleases extend through years 2012 to 2015. For a description of our financial reporting in connection with the Dulles lease agreement, see Note 14 to our consolidated financial statements appearing elsewhere in this report.

We own approximately 74 contiguous acres of land in Winchester, Virginia and the buildings on this land. The site includes our original manufacturing facility, which contains approximately 115,000 square feet of space, our research and development technical facility, which contains approximately 30,000 square feet of space, a mixed-use building, which contains approximately 173,000 square feet of space, and an additional manufacturing facility, which contains approximately 150,000 square feet of space. We own the land and the manufacturing facility on the Fernley, Nevada site, which contains approximately 250,000 square feet of manufacturing space. Our Fernley site is located on approximately 37 acres, which includes outside open storage. We own approximately 102 acres of land in Olive Branch, Mississippi and the buildings on this land. The site contains four buildings with approximately 200,000 square feet for manufacturing and raw material handling operations. In September 2007, we suspended operations at our Olive Branch facility and consolidated all of our manufacturing operations into our Winchester and Fernley sites.

We lease a total of approximately 1.1 million square feet of storage warehouse space under leases with expiration dates ranging from 2010 to 2015. For information about these leases, see Note 11 to our consolidated financial statements appearing elsewhere in this report.

The equipment and machinery we use in our operations consist principally of plastic and wood conveying and processing equipment. We own all of our manufacturing equipment. We lease substantially all of our forklift equipment at our facilities under operating leases.

We regularly evaluate our various facilities and equipment and make capital investments where necessary. In 2009, we spent a total of $6.9 million on capital expenditures, primarily to make process and productivity improvements. We estimate that our capital expenditures in 2010 will be approximately $10 million. We expect to use these expenditures principally to make process and productivity improvements and upgrade systems.

Item 3. Legal Proceedings

On October 16, 2006, Ron Nystrom commenced a lawsuit against the Company in the United States District Court for the Eastern District of Virginia, Norfolk Division, which also named Home Depot, Inc. and Snavely Forest Products, Inc. as defendants. Mr. Nystrom alleged that the Company s Accents® product and other new

Salaries and fringe benefits	**29,820,256**	26,331,933
Provision for credit losses	**27,773,811**	25,708,036
Other operating expenses	**24,559,864**	21,104,041
Total expenses	**94,901,878**	

85,000,622

Income before income taxes

66,014,409

53,963,182

Provision for income taxes

24,256,810

19,790,740

Net income	**41,757,599**	34,172,442
Other comprehensive income (loss), net of income tax effects of approximately $(420,000) in 2011 and ($54,000) in 2010:		
Unrealized gain on interest rate swap agreements		58,091

Unrealized holding gains on securities	**790,837**	198,629
Reclassification adjustments for amounts included in net income	**(113,116)**	(8,373)
Other comprehensive income	**677,721**	248,347

Comprehensive income	
$	**42,435,320**
$	34,420,789

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Consolidated Statements of Changes in Stockholders Equity

Years ending December 31, 2011 and 2010	**Common Stock**	**Accumulated Other Comprehensive Loss**	**Retained Earnings**	**Total**
Balance, January 1, 2010	$ 165,801	$ 715,913	$ 127,867,593	$ 128,749,307
Net income			34,172,442	34,172,442
Dividends paid			(14,227,352)	(14,227,352)
Change in unrealized gain on interest rate swap agreements		151,867		151,867
Change in net unrealized gain on investment securities available for sale		96,480		96,480
Balance, December 31, 2010	165,801	964,260	147,812,683	148,942,744
Net income			**41,757,599**	**41,757,599**
Dividends paid			**(19,058,782)**	**(19,058,782)**
Change in net unrealized gain on investment securities available for sale		**677,721**		**677,721**
Balance, December 31, 2011	**$ 165,801**	**$ 1,641,981**	**$ 170,511,500**	**$ 172,319,282**

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Consolidated Statements of Cash Flows

Years ending December 31,	2011	2010
Cash flows from operating activities:		
Net income	**$ 41,757,599**	$ 34,172,442
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization, net	**1,459,798**	1,425,709
Amortization of premiums on securities, net	**359,200**	282,109
Gain on sale of investments, net	**(221,279)**	(258,179)
Loss from sale and impairments of real estate	**346,362**	170,668
Gain on sale of other assets	**(91,733)**	(29,887)
Deferred income tax provision (benefit)	**(534,903)**	401,552
Provision for credit losses	**27,773,811**	25,708,036
Net loan origination costs deferred	**(501,843)**	(406,693)
Purchase of trading securities	**(8,773)**	(6,647)
Changes in operating assets and liabilities:		
Prepaid reinsurance	**(196,397)**	(178,550)
Reinsurance recoverables	**(184,133)**	(84,026)
Other receivables	**44,544**	(19,324)
Other assets	**(105,679)**	(61,660)
Policy claim reserves	**107,769**	145,316
Accounts payable and accrued expenses	**2,991,331**	(912,209)
Income taxes payable	**(163,229)**	(902,262)
Unearned premiums	**3,922,231**	3,320,566
Other liabilities	**471,741**	244,634
Net cash provided by operating activities	**77,226,417**	63,011,595
Cash flows from investing activities:		
Finance receivables purchased	**(958,436)**	(4,443,673)
Finance receivables originated	**(418,864,398)**	(386,367,797)
Finance receivables repaid	**346,854,471**	325,842,406
Proceeds from sales of real estate	**693,546**	785,404
Proceeds from calls or maturities of investment securities	**3,365,000**	2,535,000
Proceeds from sales of investment securities	**5,552,832**	5,886,122
Purchases of investment securities	**(11,425,681)**	(9,505,345)
Proceeds from sales of property and equipment	**77,338**	42,872
Purchase of property and equipment	**(1,445,352)**	(1,566,229)
Net cash used in investing activities	**(76,150,680)**	(66,791,240)
Cash flows from financing activities:		
Net changes in short-term borrowings	**19,959,657**	20,775,517
Dividends paid	**(19,058,782)**	(14,227,352)
Net cash provided by financing activities	**900,875**	6,548,165
Increase in cash and cash equivalents	**1,976,612**	2,768,520

Cash and cash equivalents at beginning of year		**5,818,312**		3,049,792
Cash and cash equivalents at end of year	**$**	**7,794,924**	$	5,818,312
Supplemental cash flow disclosures:				
Non-cash activities - Real estate acquired in satisfaction of finance receivables	**$**	**1,090,000**	$	1,107,000
Interest paid	**$**	**8,102,000**	$	7,537,000
Income taxes paid	**$**	**24,957,000**	$	20,303,000

See notes to consolidated financial statements.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

Business and Basis of Consolidation

First Tower Corp is engaged in consumer lending and related insurance activities through its wholly-owned subsidiaries, Tower Loan of Mississippi, Inc., First Tower Loan, Inc., Gulfco of Mississippi, Inc., Gulfco of Louisiana, Inc., Tower Loan of Missouri, Inc., Tower Auto Loan, Inc., American Federated Insurance Company, and American Federated Life Insurance Company, all of which are collectively referred to as the Company . The Company acquires and services finance receivables (direct loans, real estate loans and sales finance contracts) through branch offices principally located in Mississippi, Louisiana and Missouri. In addition, the Company writes credit insurance when requested by its loan customers.

The Company is subject to various state laws and regulations in each of the states in which it operates and which are enforced by the respective state regulatory authorities. These state laws and regulations impact the economic terms of the Company s products. As a result, the terms of products offered by the Company vary among the states in which it operates in order to comply with each state s specific laws and regulations.

The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

In connection with the preparation of the consolidated financial statements, management of the Company evaluated subsequent events through March 26, 2012, which is the date the consolidated financial statements were available to be issued.

Accounting Standards Codification

The Financial Accounting Standards Board s (FASB) Accounting Standards Codification (ASC) became effective on July 1, 2009. At that date, the ASC became FASB s officially recognized source of authoritative U.S. generally accepted accounting principles (GAAP) applicable to all public and non-public non-governmental entities, superseding existing FASB, American Institute of Certified Public Accountants (AICPA), Emerging Issues Task Force (EITF) and related literature. All other accounting literature is considered non-authoritative for a non-public or non-governmental entity. The switch to the ASC affects the way entities refer to U.S. GAAP in financial statements and accounting policies. Citing particular content in the ASC involves specifying the unique numeric path to the content.

Use of Estimates

The Company s consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing its financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and the reported amounts of revenues and expenses for the years then ended. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to change include the determination of the allowance for credit losses, policy claim reserves and the valuation of investments.

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NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Investment in Trading Securities

The Company has an investment in a large capitalization equity mutual fund which it accounts for using the fair value option allowed by ASC 825-10 and which is classified as a trading security. Changes in the unrealized gains and losses of this investment are recognized through earnings. Dividends on trading securities are recognized in net investment income.

Fair Value Measurements

The Company carries its trading securities, and its investment securities available-for-sale at fair value on a recurring basis and measures certain other assets and liabilities at fair value on a nonrecurring basis using a hierarchy of measurements which requires it to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Three levels of inputs are used to measure fair value:

Level 1 Valuations based on unadjusted quoted prices for identical assets in active markets accessible at the measurement date.

Level 2 Valuations derived for similar assets in active markets, or other inputs that are observable or can be corroborated by market data.

Level 3 Valuations derived from unobservable (supported by little or no market activity) inputs that reflect an entity s best estimate of what hypothetical market participants would use to determine a transaction price at the reporting date.

When quoted market prices in active markets are unavailable, the Company determines fair value using various valuation techniques and models based on a range of observable market inputs including pricing models, quoted market price of publicly traded securities with similar duration and yield, time value, yield curve, prepayment speeds, default rates and discounted cash flow. In most cases, these estimates are determined based on independent third party valuation information, and the amounts are disclosed in the Level 2 of the fair value hierarchy. Generally, the

Company obtains a single price or quote per instrument from independent third parties to assist in establishing the fair value of these investments.

If quoted market prices and independent third party valuation information are unavailable, the Company produces an estimate of fair value based on internally developed valuation techniques, which, depending on the level of observable market inputs, will render the fair value estimate as Level 2 or 3. On occasions when pricing service data is unavailable, the Company may rely on bid/ask spreads from dealers in determining fair value.

To the extent the Company determines that a price or quote is inconsistent with actual trading activity observed in that investment or similar investments, or if the Company does not think the quote is reflective of the market value for the investment, the Company internally develops a fair value using this other market information and discloses the input as a Level 3.

Investment Securities Available for Sale

Investments in debt securities are classified as available for sale. Available for sale securities are carried at fair value, with changes in the fair value of such securities being reported as other

First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

comprehensive income (loss), net of related deferred income taxes (benefit). When the fair value of a security falls below carrying value, an evaluation must be made to determine if the unrealized loss is a temporary or other than temporary impairment. Impaired debt securities that are not deemed to be temporarily impaired are written down to net realizable value by a charge to earnings to the extent the impairment is related to credit losses or if the Company intends, or more-likely-than not will be required, to sell the security before recovery of the security s amortized cost basis. In estimating other than temporary impairments, the Company considers the duration of time and extent to which the amortized cost exceeds fair value, the financial condition of the issuer, and the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for anticipated recovery in fair value.

Premiums and discounts on debt securities are recognized as adjustments to net investment income by the interest method over the period to maturity and adjusted for prepayments as applicable. Realized gains and losses on sales of investment securities are determined using the specific identification method.

Finance Receivables

Finance receivables are stated at the amount of unpaid principal and finance charges, including deferred loan costs, and reduced by unearned finance charges, unearned discounts and an allowance for credit losses. For finance receivables originated by the Company, non-refundable loan origination fees and certain direct origination costs are deferred and recognized as an adjustment of the finance receivable yield over the contractual life of the related loan. Unamortized amounts are recognized in income when finance receivables are renewed or paid in full.

For a significant group of finance receivables purchased from other lenders, the Company recognizes finance charge income pursuant to the provisions ASC 310-30, *Loans and Debt Securities Acquired with Deteriorated Credit Quality*, for its investment in finance receivables. ASC 310-30 limits the yield that may be accreted (accretable yield) to the excess of the Company s estimate of undiscounted expected principal, interest and other cash flows (cash flows expected at the acquisition to be collected) over the Company s initial investment in the finance receivables. Prepayment expectations are not considered in this evaluation. Subsequent increases in cash flows expected to be collected are recognized prospectively through adjustment of the finance receivables yield over its remaining life. Decreases in cash flows expected to be collected are recognized as impairment to the finance receivable portfolios.

Real Estate Acquired by Foreclosure

The Company records real estate acquired by foreclosure at the lesser of the outstanding finance receivable amount (including accrued interest, if any) or fair value, less estimated costs to sell, at the time of foreclosure. Any resulting loss on foreclosure is charged to the allowance for credit losses and a new basis is established in the property. A valuation allowance and a corresponding charge to operations is established to reflect declines in value subsequent to acquisition, if any, below the new basis. Operating expenses of such properties, net of related income,

and gains and losses on their disposition are included in other operating expenses.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Property and Equipment

Property and equipment are stated at cost. Depreciation is computed using the straight-line method. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts, and any resulting gain or loss is recognized in income for the period. The cost of maintenance and repairs is charged to income when incurred; significant renewals and betterments are capitalized. The Company evaluates the recoverability of property, plant and equipment and other long-term assets when events or changes in circumstances indicate that the carrying value of such assets may not be recoverable, based upon expectations of non-discounted cash flows and operating income.

Income Recognition

Precomputed finance charges are included in the gross amount of the Company s finance receivables. These precomputed charges are deferred and recognized as income on an accrual basis using the effective interest method over the terms of receivables. However, with certain exceptions, state regulations allow interest refunds to be made according to the Rule of 78 s method for payoffs and renewals. Since a significant percentage of the Company s precomputed accounts are paid off or renewed prior to maturity, the result is that a majority of the precomputed accounts effectively yield on a Rule of 78 s basis. The difference between income previously recognized under the interest yield method and the Rule of 78 s method is recognized as an adjustment to interest income at the time of the renewal or payoff.

Renewals and refinancings require that the borrower meet the underwriting guidelines similar to a new customer and, as a result, the interest rate and effective yield, as well as the other terms of the refinanced receivables are comparable to finance receivables with customers with similar risks who are not refinancing; therefore, all renewals and refinancings are treated as new finance receivables. Unearned finance charges and discounts from the original receivable being renewed or refinanced are recognized in interest income when the new finance receivable is granted. Finance charge refunds, net of any applicable prepayment penalties, are charged to interest income at the time of the new finance receivable.

Insurance premiums on credit life and accident and health policies written by the Company are earned over the term of the policy using the pro-rata method, for level-term life policies, and the effective yield method, for decreasing-term life policies. Premiums on accident and health policies are earned based on an average of the pro-rata method and the effective yield method. Property and casualty credit insurance premiums written by the Company are earned over the period of insurance coverage using the pro-rata method or the effective yield method, depending on whether the amount of insurance coverage generally remains level or declines.

Commissions earned from the sale of accidental death and dismemberment insurance coverage and motor club memberships to finance customers are recognized at the time of origination. The Company has no future obligations related to the sale of these products. Other income

includes commissions earned of $8,025,000 in 2011 and $7,044,000 in 2010.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Credit Losses

The allowance for credit losses is determined by several factors based upon each portfolio segment. Segments in the finance receivable portfolio include personal property, real estate and other. Historical loss experience is the primary factor in the determination of the allowance for credit losses. An evaluation is performed to compare the amount of accounts charged off, net of recoveries of such accounts, in relation to the average net outstanding finance receivables for the period being reviewed. Historically, management has found that this methodology has provided an adequate allowance due to the Company s loan portfolio segments consisting of a large number of smaller balance homogeneous finance receivables. Further, management routinely evaluates the inherent risks and change in the volume and composition of the Company s finance receivable portfolio based on its extensive experience in the consumer finance industry in consideration of estimating the adequacy of the allowance. Also considered are delinquency trends, economic conditions, and industry factors. Provisions for credit losses are charged to income in amounts sufficient to maintain an allowance for credit losses at a level considered adequate to cover the probable loss inherent in the finance receivable portfolio. Since the estimates used in determining the allowance for credit losses are influenced by outside factors, such as consumer payment patterns and general economic conditions, there is uncertainty inherent in these estimates, making it reasonably possible that they could change. Interest on past due finance receivables is recognized until charge-off. Finance receivables are generally charged off when they are five months contractually past due.

Policy Claim Reserves

Policy claim reserves represent (i) the liability for losses and loss-adjustment expenses related to credit property contracts and (ii) the liabilities for future policy benefits related to credit life and accident and health insurance. The liability for loss and loss adjustment expenses includes an amount determined from loss reports and individual cases and an amount, based on past experience, for losses incurred but not reported. The liabilities for future policy benefits have been computed utilizing accepted actuarial techniques. Such liabilities are necessarily based on estimates and, while management believes that the amount is adequate, the ultimate liability may be in excess of or less than the amounts provided. The methods for making such estimates and for establishing the resulting liabilities are continually reviewed, and any adjustments are reflected in earnings currently.

Reinsurance

The Company reduces its exposure relating to credit accident and health insurance through a quota share reinsurance agreement (see Note 4). Amounts recoverable from the reinsurer are estimated in a manner consistent with the claim liability associated with the reinsured policy.

Income Taxes

Deferred tax assets and liabilities are determined based on the differences between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, the Company considers certificates of deposit and all short-term securities with original maturities of three months or less to be cash equivalents.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

Fair Value Disclosures of Financial Instruments

The following methods and assumptions were used by the Company to estimate the fair value of each class of financial instruments:

Cash and Cash Equivalents

The carrying amounts reported in the consolidated balance sheets for these financial instruments approximate their fair values.

Investment Securities

The fair value of investments in trading securities and securities available for sale are generally obtained from independent pricing services based upon valuations for similar assets in active markets or other inputs derived from objectively verifiable information.

Finance Receivables

The fair value of finance receivables approximates the carrying value since the estimated life, assuming prepayments, is short-term in nature.

Other Receivables and Payables

The carrying value amounts reported in the consolidated financial statements approximated their fair value.

Notes Payable

The carrying amounts of borrowings under the line-of-credit agreements approximated their fair values as the interest charged for these borrowings fluctuate with market changes.

Comprehensive Income

Comprehensive income for the Company consists of net earnings, changes in unrealized gains (losses) on investment securities classified as available-for-sale and changes in the fair value of interest rate swap agreements, net of taxes, and is presented in the consolidated statements of income and comprehensive income.

Advertising

Advertising costs are expensed as incurred. Advertising expenses approximated $4,071,000 in 2011 and $3,476,000 in 2010.

Effects of Recent Accounting Guidance

In May 2011, the FASB issued a new accounting standard update under Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Faire Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs.* The amendments in ASU 2011-4 generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value has changed. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard will be effective for the Company on January 1, 2012.

NOTE 1 SUMMARY OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (Continued)

In June 2011, the FASB issued new authoritative accounting guidance under ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income.* ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. As a result companies must report comprehensive income in either a single continuous statement of comprehensive income which contains two sections, net income and other comprehensive income, or in two separate but consecutive statements. This new guidance is to be applied retrospectively and will be effective for the Company on January 1, 2012.

In December 2011, the FASB issued new authoritative accounting guidance under ASU No. 2011-12, *Comprehensive Income (Topic 220): Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05.* ASU 2011-12 defers certain aspects of ASU 2011-05 that relate to the presentation of reclassification adjustments. This new guidance will be effective for the Company on January 1, 2012.

In October 2010, the FASB issued new authoritative accounting guidance under ASU No. 2010-26, *Financial Services Insurance (Topic 944), Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.* ASU 2010-26 amends prior accounting guidance to specify which costs incurred in the acquisition of new or renewal insurance contracts qualify for deferral. This standard will be effective for the Company on January 1, 2012.

The Company is currently evaluating the impact the adoption of these accounting standards updates could have on its consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2010 consolidated financial statements in order to conform to the method of presentation used in 2011.

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Notes to Consolidated Financial Statements

NOTE 2 INVESTMENT SECURITIES

The cost or amortized cost of securities available for sale and their approximate fair values at December 31, 2011 and 2010 were as follows:

December 31, 2011	Cost or Amortized Cost	Approximate Fair Value	Gross Unrealized Gains	Gross Unrealized Losses
Debt securities:				
U.S. Government agencies and corporations	$ 2,598,669	$ 2,692,597	$ 93,928	$
Obligations of states and political subdivisions	18,199,841	19,603,799	1,430,401	26,444
Corporate securities	14,504,237	15,503,864	1,023,929	24,302
Mortgage-backed securities	2,457,786	2,554,518	107,807	11,075
Total investment securities	$ 37,760,533	$ 40,354,778	$ 2,656,065	$ 61,821
December 31, 2010				
Debt securities:				
U.S. Government agencies and corporations	$ 2,881,111	$ 2,951,081	$ 90,456	$ 20,486
Obligations of states and political subdivisions	17,304,321	17,869,374	667,265	102,213
Corporate securities	13,127,158	13,900,694	839,300	65,764
Mortgage-backed securities	2,116,111	2,203,072	90,133	3,172
Total investment securities	$ 35,428,701	$ 36,924,221	$ 1,687,154	$ 191,635

Accumulated other comprehensive income (loss) includes unrealized gains on available for sale securities, net of income tax effects, of approximately $1,642,000 and $964,000 at December 31, 2011 and 2010, respectively.

The length of time temporarily impaired securities have been held in a loss position as of December 31, 2010 and 2009 is summarized below:

	Less than 12 months		12 months or more		Total	
December 31, 2011	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
	$ 297,920	$ 1,393	$ 771,596	$ 25,051	$ 1,069,516	$ 26,444

Obligations of states and political subdivisions						
Corporate securities	2,225,305	24,302			2,225,305	24,302
Mortgage-backed securities	730,461	11,075			730,461	11,075
Total	$ 3,253,686	$ 36,770	$ 771,596	$ 25,051	$ 4,025,282	$ 61,821

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 2 INVESTMENT SECURITIES (Continued)

December 31, 2010	Less than 12 months		12 months or more		Total	
	Estimated Fair Value	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**	**Estimated Fair Value**	**Unrealized Losses**
U.S. Government and agencies securities	$ 934,029	$ 20,486			$ 934,029	$ 20,486
Obligations of states and political subdidivisions	2,290,500	67,105	$ 1,349,483	$ 35,108	3,639,983	102,213
Corporate securities	1,813,081	65,764			1,813,081	65,764
Mortgage-backed securities	414,284	3,172			414,284	3,172
Total	$ 5,451,894	$ 156,527	$ 1,349,483	$ 35,108	$ 6,801,377	$ 191,635

Substantially all gross unrealized losses at December 31, 2011 and 2010 were attributable to interest rate changes and general disruptions in the credit market subsequent to purchase rather than an adverse change in cash flows or a fundamental weakness in the credit quality of the issuer or the underlying assets and are thus considered temporarily impaired. Due to the issuers continued satisfaction of the securities obligations in accordance with contractual terms, the expectation that they will continue to do so and the Company s intent and ability relative to these investments, management believes the securities in unrealized loss positions are temporarily depressed.

As of December 31, 2011 the Company had 26 debt securities with temporary impairments, including 5 securities classified as obligations of state and political subdivisions, 17 securities classified as corporate securities, and 4 investments classified as mortgage-backed securities.

As of December 31, 2010, the Company had 31 debt securities with temporary impairments, including 1 security classified as U.S. Government agencies and corporations, 21 securities classified as obligations of state and political subdivisions, 7 securities classified as corporate securities, and 2 investments classified as mortgage-backed securities.

Management of the Company evaluates securities for other-than-temporary impairment (OTTI) no less than annually or when economic or market concerns warrant such evaluation. The evaluation is based upon factors such as the creditworthiness of the issuer, the underlying collateral, if applicable, and the continuing performance of the securities. Management also evaluates other facts and circumstances that may be indicative of an OTTI condition. This includes, but is not limited to, an evaluation of the type of security, length of time and extent to which the fair value has been less than cost, and near-term prospects of the issuer.

The Company segregates the OTTI impact on impaired securities where impairment in value was deemed to be other than temporary between the component representing credit loss and the component representing loss related to other factors.

The Company assesses whether a credit loss exists by considering whether (i) the Company has the intent to sell the security, (ii) it is more likely than not that it will be required to sell the security before recovery, or (iii) it does not expect to recover the entire amortized cost basis of a debt security. The portion of the fair value decline attributable to credit loss is recognized as a charge to earnings. The credit loss evaluation is determined by comparing the present value of the cash

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 2 INVESTMENT SECURITIES (Continued)

flows expected to be collected, discounted at the rate in effect before recognizing any OTTI with the amortized cost basis of the debt security. The Company uses the cash flow expected to be realized from the security, which includes assumptions about interest rates, timing and severity of defaults, estimates of potential recoveries, the cash flow distribution from the bond indenture and other factors, then applies a discount rate equal to the effective yield of the security. The difference between the present value of the expected cash flows and the amortized book value is considered a credit loss. The difference between the fair market value and the security s remaining amortized cost is recognized in other comprehensive income or loss.

A rollforward of credit losses recognized in earnings on available-for-sale securities, for which a portion of OTTI loss remains in AOCI, is as follows:

In thousands, for the years ending December 31,	**2011**	**2010**
Amounts related to credit losses on securities held, beginning of year	**$ 1,161,142**	$ 1,161,142
Less accumulated losses on investments disposed of during the year	**(646,750)**	
Amounts related to credit losses on securities held, end of year	**$ 514,392**	$ 1,161,142

Major categories of net investment income are summarized as follows:

Years ending December 31,	**2011**	**2010**
Debt securities	**$ 1,432,208**	$ 1,511,637
Common stocks	**8,773**	6,646
Mortgage and collateral loans	**7,800**	7,800
Cash and short-term investments	**1,260**	1,317
	1,450,041	1,527,400
Investment expenses	**(138,301)**	(132,567)
Net investment income	**$ 1,311,740**	$ 1,394,833

Net realized investment gains are summarized as follows:

Years ending December 31,		**2011**		**2010**
Gross realized gains on sale of securities available for sale	**$**	**195,681**	$	180,531
Gross realized losses on sale of securities available for sale		**(12,497)**		(15,109)
Gain from investments in trading securities held		**38,095**		92,757
Net realized investment gains	**$**	**221,279**	$	258,179

Proceeds from sales of investment securities aggregated approximately $5,553,000 in 2011 and $5,886,000 in 2010.

The amortized cost and approximate fair value of debt securities at December 31, 2011, by contractual maturity, is shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepay penalties.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 2 INVESTMENT SECURITIES (Continued)

December 31, 2011	Cost or Amortized Cost	Approximate Fair Value
Due in one year or less	$ 3,550,711	$ 3,577,242
Due after one year but less than five years	12,292,762	13,051,635
Due after five years but less than ten years	16,409,943	17,951,714
Due after ten years	3,049,331	3,219,669
Mortgage-backed securities	2,457,786	2,554,518
Total debt securities	$ 37,760,533	$ 40,354,778

Investment securities with carrying values of approximately $1,901,000 and $1,868,000 and with estimated fair values of $1,939,000 and $1,955,000 at December 31, 2011 and 2010, respectively, were pledged by the Company with various states as required by state law.

NOTE 3 FINANCE RECEIVABLES

Finance receivables at December 31, 2011 and 2010, are as follows:

December 31,	2011	2010
Consumer finance receivables:		
Personal property	**$ 416,730,299**	$ 361,618,137
Real estate	**58,741,778**	60,501,274
Other	**68,347,837**	60,233,159
	543,819,914	482,352,570
Add (deduct):		
Net deferred origination costs	**4,626,769**	4,124,926
Unearned income	**(146,933,781)**	(129,402,034)
Allowance for credit losses	**(31,028,025)**	(31,196,893)
Finance receivables, net	**$ 370,484,877**	$ 325,878,569

Changes in the allowance for credit losses are as follows:

December 31,	2011	2010
Balance at beginning of year	**$ 31,196,893**	$ 32,161,443
Provision for credit losses	**27,773,811**	25,708,036
Receivables charged-off	**(37,375,224)**	(36,090,602)
Charge-offs recovered	**9,432,545**	9,418,016
Balance at end of year	**$ 31,028,025**	$ 31,196,893

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 3 FINANCE RECEIVABLES (continued)

The balance in the allowance for possible loans losses by portfolio segment at December 31, 2011 was as follows:

December 31, 2011	Balance at Beginning of Year	Charge-offs	Recoveries	Provision for Loan Losses	Balance at End of Year
Personal Property	$ 29,019,002	$ (34,802,740)	$ 8,760,608	$ 25,990,095	$ 28,966,965
Real Estate	658,766	(622,553)	89,761	409,870	535,844
Other	1,519,125	(1,949,931)	582,176	1,373,846	1,525,216
Total loans	$ 31,196,893	$ (37,375,224)	$ 9,432,545	$ 27,773,811	$ 31,028,025

The Company classifies delinquent accounts based upon the number of contractual installments past due. An aging of delinquent gross finance receivables as of December 31, 2011 and 2010 is as follows:

December 31, 2011	Current	Past Due 30-90 Days	Past Due 91-150 Days	Past Due Greater Than 150 Days	Total
Personal Property	$ 368,560,171	$ 37,626,554	$ 10,532,706	$ 10,868	$ 416,730,299
Real Estate	53,370,952	4,747,231	524,467	99,128	58,741,778
Other	65,195,608	2,573,741	578,488		68,347,837
Gross finance receivables	$ 487,126,731	$ 44,947,526	$ 11,635,661	$ 109,996	$ 543,819,914
December 31, 2010					
Personal Property	$ 319,811,286	$ 32,546,655	$ 9,256,807	$ 3,389	$ 361,618,137
Real Estate	54,455,638	4,998,581	761,048	286,007	60,501,274
Other	57,426,455	2,255,093	551,611		60,233,159
Gross finance receivables	$ 431,693,379	$ 39,800,329	$ 10,569,466	$ 289,396	$ 482,352,570

Nonperforming loans consisted of loans past due greater than 150 days and approximated $110,000 and $289,000, as of December 31, 2011 and 2010, respectively. Additionally, the Company had gross finance receivables relating to customers in bankruptcy and which the terms of the original contract have been modified approximating $3,635,000 and $2,998,000 as of December 31, 2011 and 2010, respectively.

The amount of unpaid balances related to finance receivables acquired with deteriorated credit quality was immaterial for all periods presented.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 4 REINSURANCE

The Company has entered into a quota share reinsurance agreement that cedes 40% of its credit accident and health inforce business in order to limit its exposure on credit disability coverages. Reinsurance contracts do not relieve the Company from its primary obligation to policyholders. Failure of any reinsurer to honor its obligations could result in losses to the Company.

The ceded reinsurance agreement contains a retrospective rating provision that results in a favorable adjustment to the reinsurance premiums if certain underwriting results are achieved on the reinsured business during the experience period. The Company estimates the amount of ultimate premium adjustment that the Company may earn upon completion of the experience period and recognizes an asset for the difference between the initial reinsurance premiums paid and the estimated ultimate premium. The Company adjusts such estimated ultimate premium amounts during the course of the experience period based on actual results to date. The resulting adjustment is recorded as either a reduction of or an increase to the ceded premiums for the period. Included in reinsurance recoverables at December 31, 2011 and 2010 are estimated receivables relating to the retrospective rating provisions of approximately $1,191,000 and $1,006,000, respectively. During 2011 and 2010, ceded premiums have been reduced by retrospective premium adjustments of approximately $941,000 and $756,000, respectively.

The effect of reinsurance on premiums written and earned is as follows:

	2011				2010			
		Written		Earned		Written		Earned
Direct	**$**	**30,553,126**	**$**	**26,827,291**	$	26,980,414	$	23,838,398
Ceded		**(911,506)**		**(911,506)**		(916,891)		(916,891)
Net premiums	**$**	**29,641,620**	**$**	**25,915,785**	$	26,063,523	$	22,921,507

NOTE 5 PROPERTY AND EQUIPMENT

Property and equipment at December 31, 2011 and 2010 is as follows:

	Estimated Useful Lives		2011		2010
Land		**$**	**302,167**	$	302,167

Building and improvements	15 to 40 years	**2,281,197**	2,242,383
Office furniture and fixtures	5 to 10 years	**2,515,974**	2,243,135
Data processing equipment	3 years	**6,659,215**	6,273,374
Automotive equipment	3 years	**1,146,819**	923,824
Leasehold improvements	5 years	**2,159,847**	1,981,776
		15,065,219	13,966,659
Less accumulated depreciation		**10,356,077**	9,257,465
Property and equipment, net		**$ 4,709,142**	$ 4,709,194

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 6 INDEBTEDNESS AND CREDIT ARRANGEMENTS

In October 2011, the Company entered into a new revolving loan agreement, which is used to finance its consumer lending operations, to provide for an increase in the credit facility. The amended loan agreement terminates on October 14, 2013 and provides for a total facility of $240,000,000. However, borrowings are limited to availability, as defined in the agreement.

Borrowings under the agreement bear interest at an annualized rate of LIBOR plus 3% with a floor rate of 4% or a reference rate, as defined, plus 2%. Borrowings are collateralized by substantially all of the Company s consumer finance assets, including all finance receivables and intangibles. Prior to October 2011, borrowings under the agreement accrued interest at an annualized rate of LIBOR plus 3% with a floor rate of 4% or a reference rate, as defined, plus 2% and the total facility was $210,000,000.

The loan agreement contains covenants that require First Tower Loan, Inc., Tower Loan of Mississippi, Inc., Tower Loan of Missouri, Inc. and the Gulfco subsidiaries to maintain certain interest coverage and unsubordinated debt to borrowing base ratios. In addition, these finance company subsidiaries are required to maintain a certain minimum level of tangible net worth. At December 31, 2011, the Company was in compliance with the covenants.

In addition, the Company has a $7,000,000 revolving line of credit with a bank which expires June 30, 2012. Advances under the line of credit bear interest at one-month LIBOR plus 2.75% with a floor rate of 3.75%, adjusted monthly, and are collateralized by all of the outstanding shares of American Federated Life Insurance Company and certain deeds of trust. Prior to June 2010, this revolving line of credit accrued interest at a variable rate of LIBOR plus 2.80%.

At December 31, 2011 and 2010, the amount outstanding under the revolving loan agreement was approximately $217,281,000 and $196,833,000, respectively, with an average effective interest rate of 4.12%. The amount outstanding under the revolving line of credit with the bank was approximately $5,478,000 with an interest rate of 3.75% at December 31, 2011 and $5,967,000 with an interest rate of 3.75% at December 31, 2010. Interest is payable monthly.

Prior to 2010, the Company terminated an interest rate swap agreement that had been entered into for the purpose of hedging the interest rate risk exposure on $5 million of its indebtedness from floating interest rates to a fixed rate. Upon termination the realized loss was amortized over the maturity of the terminated swap and resulted in approximately $152,000 of additional interest expense during 2010.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 7 POLICY CLAIMS RESERVES

Activity in policy claim reserves, including claim adjustment expenses, is summarized as follows:

December 31,	2011	2010
Balance at beginning of year	**$ 2,367,089**	$ 2,221,773
Less reinsurance recoverables	**(671,515)**	(617,189)
Net balance at beginning of year	**1,695,574**	1,604,584
Incurred related to:		
Current year	**4,828,932**	4,302,988
Prior years	**(251,513)**	(201,037)
Total incurred	**4,577,419**	4,101,951
Paid related to:		
Current year	**3,405,902**	2,993,735
Prior years	**1,064,687**	1,017,226
Total paid	**4,470,589**	4,010,961
Net balance at end of year	**1,802,404**	1,695,574
Plus reinsurance recoverables	**672,454**	671,515
Balance at end of year	**$ 2,474,858**	$ 2,367,089

NOTE 8 INCOME TAXES

The Company files a consolidated income tax return in the U. S. federal jurisdiction and operates in multiple state tax jurisdictions which requires the appropriate allocation of income and expense to each state based on a variety of apportionment or allocation bases.

The provisions for income taxes consisted of the following:

Years ending December 31,		**2011**		**2010**
Current provision	**$**	**24,791,713**	$	19,389,188
Deferred expense (benefit)		**(534,903)**		401,552
Provision for income taxes	**$**	**24,256,810**	$	19,790,740

The Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction and the states in which it operates.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 8 INCOME TAXES (Continued)

The Company is subject to examination by federal and state tax authorities. Results of these examinations may produce indicated liabilities which differ from Company estimates and provisions. The Company continually evaluates its exposure to possible tax assessments arising from examinations and records its estimate of possible exposure based on current facts and circumstances. With minimum exception, the Company and its subsidiaries are no longer subject to income tax examinations prior to 2008 in the jurisdictions in which they file.

The Company did not have unrecognized tax benefits as of December 31, 2011 and does not expect this to change significantly over the next 12 months. It is the Company s policy to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2011 and 2010, the Company had no accrued interest or penalties related to uncertain tax positions.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The tax effects of significant items comprising the Company s net deferred tax assets are as follows:

December 31,	**2011**	**2010**
Deferred tax assets:		
Writedown of securities	**$ 196,755**	$ 444,136
Allowance for credit losses	**11,868,220**	11,932,812
Tax basis deferred policy acquisition cost	**494,533**	453,965
Intangible assets	**227,072**	313,726
Policy claim reserves and unearned premiums	**2,091,535**	1,937,695
Capital loss in excess of capital gain	**528,303**	333,168
Other accrued employee benefits	**316,622**	253,556
Capitalized selling costs	**486,157**	
Unrealized holding loss on trading securities	**425,885**	440,460
	16,635,082	16,109,518
Valuation allowance	**(514,040)**	(602,592)
	16,121,042	15,506,926
Deferred tax liabilities:		
Reinsurance recoverables	**95,625**	95,625
Property and equipment	**847,189**	781,145
Unrealized gain on securities available for sale	**992,297**	572,036
Other	**70,020**	56,112
	2,005,131	1,504,918

Net deferred tax asset	**$**	**14,115,911**	$	14,002,008

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 8 INCOME TAXES (Continued)

The provision for income taxes differs from the amount computed by applying the federal statutory rate of 35% to income before income taxes as follows:

December 31,	2011	2010
Tax based on federal statutory rate	**$ 23,105,045**	$ 18,887,114
State income taxes	**1,601,785**	1,319,443
Small life insurance company deduction	**(354,158)**	(396,136)
Tax-exempt interest and dividend exclusion	**(199,121)**	(192,165)
Change in valuation allowance	**(88,552)**	(80,941)
Other	**191,811**	253,425
Provision for income taxes	**$ 24,256,810**	$ 19,790,740

The Company has approximately $1,284,000 of federal capital loss carryforwards that will begin to expire in 2013, if not used.

The valuation allowance is primarily related to investment loss carryovers not expected to be realized and the small life insurance company deduction of the Company s life insurance subsidiary.

NOTE 9 EMPLOYEE PROFIT SHARING PLAN

The Company has a profit sharing plan covering substantially all the Company s employees that includes a 401(k) provision which allows employees to contribute salary subject to the maximum contribution allowed by the IRS. The Company matches 50% of the first 6% of employee contributions. Additional contributions may be made at the discretion of the Company. Profit sharing expense approximated $1,762,000 in 2011 and $1,370,000 in 2010.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 10 STATUTORY FINANCIAL INFORMATION OF INSURANCE SUBSIDIARIES

Generally accepted accounting principles (GAAP) differ in certain respects from the accounting practices prescribed or permitted by insurance regulatory authorities (Statutory). A reconciliation between net income and stockholder s equity of the Company s insurance subsidiaries as reported under GAAP and Statutory follows:

December 31,	Net Income 2011	Stockholder s Equity 2011	Net Income 2010	Stockholder s Equity 2010
GAAP basis	**$ 14,064,480**	**$ 18,447,880**	$ 12,726,954	$ 16,279,708
Adjustments to:				
Non-admitted assets	**1,597**	**(57,276)**	1,600	(61,206)
Deferred policy acquisition costs				
Policy reserves	**(198,313)**	**246,478**	(220,356)	444,791
Deferred income taxes	**(204,562)**	**(1,373,187)**	(108,665)	(1,635,200)
Asset valuation reserve		**(62,581)**		(58,875)
Interest maintenance reserve	**21,375**	**(68,777)**	652	
Realized gain on investments	**(159,153)**		(199,516)	
Unrealized gain on investments available for sale		**(2,618,225)**		(1,519,505)
Statutory Basis	**$ 13,525,424**	**$ 14,514,312**	$ 12,200,669	$ 13,449,713

Under state statutes, each of the insurance subsidiaries is required to maintain minimum capital and surplus of $1,500,000.

Insurance regulations limit the amount of dividends that may be paid without approval of the insurance subsidiaries regulatory agency. At December 31, 2011, there were no undistributed earnings and surplus available for future distributions as dividends, without the prior approval of the State of Mississippi Insurance Department.

The National Association of Insurance Commissioners (NAIC) measures the adequacy of an insurance company s capital by its risk-based capital ratio (the ratio of its total capital, as defined, to its risk-based capital). The requirements provide a measurement of minimum capital appropriate for an insurance company to support its overall business operations based upon its size and risk profile which considers (i) asset risk, (ii) insurance risk, (iii) interest rate risk, and (iv) business risk. An insurance company s risk-based capital is calculated by applying a defined factor to various statutory-based assets, premiums, and reserve items, wherein the factor is higher for items with greater underlying risk.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 10 STATUTORY FINANCIAL INFORMATION OF INSURANCE SUBSIDIARIES (Continued)

The State of Mississippi statutes have provided levels of progressively increasing regulatory action for remedies when an insurance company s risk-based capital ratio falls below a ratio of 2:1. As of December 31, 2011, the Company s insurance subsidiaries were in compliance with these minimum capital requirements as follows:

	AFLIC	AFIC
Total adjusted capital	$ 6,625,938	$ 7,950,955
Authorized control level risk-based capital	597,177	195,377
Ratio of adjusted capital to risk based capital	11.1:1	40.7:1

NOTE 11 LEASES

The Company leases office facilities under noncancellable operating leases. Rental expense approximated $1,538,000 in 2011 and $1,421,000 in 2010. Future minimum lease payments at December 31, 2011 are as follows:

2012	$ 1,237,166
2013	885,778
2014	604,658
2015	399,708
2016	95,234

NOTE 12 CONCENTRATION OF RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of finance receivables. Concentrations of credit risk with respect to finance receivables are limited due to the large number of customers comprising the Company s customer base. These finance receivables relate mainly to customers located in Mississippi and Louisiana.

In addition, at December 31, 2011, the Company had funds on deposit with depository and investment institutions in excess of insured limits of approximately $7,005,000.

NOTE 13 BALANCES AND TRANSACTIONS WITH RELATED PARTIES

In the ordinary course of business, the Company maintains a depository and investment trustee relationship and has entered into a $7 million revolving line of credit (see Note 6) with a bank in which a principal shareholder of the parent of the Company s majority-owned parent has an interest. Additionally, this bank has a participation interest in the Company s total credit facility relating to its revolving loan agreement.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 13 BALANCES AND TRANSACTIONS WITH RELATED PARTIES (Continued)

Activities with this bank at December 31, 2011 and 2010, were as follows:

December 31,		2011		2010
Cash and cash equivalents	**$**	**7,519,673**	$	5,698,487
Notes payable to bank	**$**	**5,477,630**	$	5,966,515
Outstanding indebtedness from credit facility participation	**$**	**25,349,491**	$	23,423,104

Revenue and expenses resulting from transactions with the bank for the years ended December 31, 2011 and 2010, were as follows:

Years ending December 31,		2011		2010
Investment income (interest and other)	**$**	**963**	$	1,363
Interest expense from credit facility participation	**$**	**951,685**	$	886,819
Interest from notes payable	**$**	**139,978**	$	150,535
Service charge fee expense	**$**	**125,789**	$	108,320

NOTE 14 FAIR VALUE MEASUREMENTS

The fair value measurements by input level at December 31, 2011 and 2010 for assets and liabilities measured at fair value on a recurring basis follow:

December 31, 2011		Total		Level 1		Level 2		Level 3
Trading securities - equity mutual funds	$	997,043	$	997,043				
Available-for-sale securities:								
U.S. Government agencies and corporations		2,692,597		1,499,216	$	1,193,381		
Obligations of states and political subdivisions		19,603,799				19,235,580	$	368,219
Corporate securities		15,503,864				15,503,864		
Mortgage-backed securities		2,554,518				2,554,518		
	$	**41,351,821**	**$**	**2,496,259**	**$**	**38,487,343**	**$**	**368,219**

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 14 FAIR VALUE MEASUREMENTS (Continued)

December 31, 2010	Total	Level 1	Level 2	Level 3
Trading securities - equity mutual funds	$ 950,175	$ 950,175		
Available-for-sale securities:				
U.S. Government agencies and corporations	2,951,081	1,712,404	$ 1,238,677	
Obligations of states and political subdivisions	17,869,374		17,497,905	$ 371,469
Corporate securities	13,900,694		13,900,694	
Mortgage-backed securities	2,203,072		$ 2,203,072	
	$ 37,874,396	$ 2,662,579	$ 34,840,348	$ 371,469

Changes in assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2011 and 2010 are as follows:

Year ending December 31,	2011	2010
Balance at beginning of year	**$ 371,469**	$ 404,389
Change in unrealized loss on investments held		67,080
Recognized loss from OTTI included in earnings	**(3,250)**	
Partial redemption		(100,000)
Balance at end of year	**$ 368,219**	$ 371,469

Certain assets and liabilities are potentially measured at fair value on a nonrecurring basis (for example, when there is evidence of impairment). Assets measured at fair value on a non-recurring basis include foreclosed assets (upon initial recognition or subsequent impairment), non-financial assets and non-financial liabilities measured at fair value in the second step of a goodwill impairment test, and intangible assets and other non-financial long-lived assets measured at fair value for impairment assessment. During 2011 and 2010, certain foreclosed real estate assets, upon initial recognition, were remeasured and reported at fair value through a charge-off to the allowance for credit losses based upon the fair value of the foreclosed asset. The fair value of a foreclosed asset, upon initial recognition, is estimated using Level 2 inputs based on observable market data or Level 3 inputs based on customized discounting criteria. Foreclosed assets measured at fair value upon initial recognition during 2011 and 2010 were not material.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 15 DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying values and approximate fair values of the Company s financial instruments at December 31, 2011 and 2010, were as follows:

	2011		2010	
	Carrying Value	**Estimated Fair Value**	**Carrying Value**	**Estimated Fair Value**
Financial Assets:				
Cash and cash equivalents	**$ 7,794,924**	**$ 7,794,924**	$ 5,818,312	$ 5,818,312
Trading securities	**997,043**	**997,043**	950,175	950,175
Investment securities available for sale	**40,354,778**	**40,354,778**	36,924,221	36,924,221
Finance receivables - net	**370,484,877**	**370,484,877**	325,878,569	325,878,569
Financial Liabilities:				
Notes payable	**222,758,982**	**222,758,982**	202,799,325	202,799,325

Certain financial instruments are not carried at fair value in the accompanying consolidated balance sheets, including receivables, payables and accrued liabilities. The carrying amount of financial instruments not carried at fair value is a reasonable estimate of their fair value because of the generally short periods of time in which these related assets or liabilities are expected to be realized or liquidated, and because they do not present unanticipated credit concerns.

The estimated fair values are significantly affected by assumptions used, principally the timing of future cash flows, the discount rate, judgments regarding current economic conditions, risk characteristics of various financial instruments and other factors. Because assumptions are inherently subjective in nature, the estimated fair values cannot be substantiated by comparison to independent quotes and, in many cases, the estimated fair values could not necessarily be realized in an immediate sale or settlement of the instrument. Potential tax ramifications related to the realization of unrealized gains and losses that would be incurred in an actual sale and/or settlement have not been taken into consideration.

NOTE 16 CONTINGENCIES

As of December 31, 2011, the Company is involved in various legal actions resulting from normal business activities. Many of these actions do not specify an amount of damages. Also, many of these actions are in very early stages of discovery or discovery has not begun. As a result, legal counsel is unable to provide an estimate of the probability or range of potential exposure. However, based on its experience with lawsuits alleging similar claims, management is of the opinion that the resolution of such actions will not result in a material adverse effect on the

consolidated financial statements. Accordingly, with respect to these matters, no provision for loss or liability has been provided in the consolidated financial statements.

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First Tower Corp and Subsidiaries

Notes to Consolidated Financial Statements

NOTE 16 CONTINGENCIES (Continued)

The Company s insurance subsidiaries are required by law to participate in the guaranty associations of the various states in which they are licensed to do business. The state guaranty associations ensure payment of guaranteed benefits, with certain restrictions, to policyholders of impaired or insolvent insurance companies by assessing all other companies operating in similar lines of business. As a result, the Company is exposed to undeterminable future assessments resulting from the insolvency of other insurers. For 2011 and 2010, the expenses incurred related to guaranty assessments were minimal.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted into law. This act established the Consumer Financial Protection Bureau (CFPB) as a federal authority responsible for administering and enforcing the laws and regulations for consumer financial products and services. The legislation does not specifically target installment lending and is specifically prohibited from instituting federal usury interest rate caps. However, it is unclear to what extent the CFPB will impact the future regulation of the industry in which the Company operates.

NOTE 17 SUBSEQUENT EVENTS

On March 19, 2012, the Company entered into a definitive agreement (the Agreement) to sell an 80.1% majority-interest in all of its operating subsidiaries to Prospect Capital Corporation (Prospect) for $110.2 million of cash and 14.5 million shares of Prospect common stock (NASDAQ: PSEC). Under the terms of the agreement, Prospect has the option, at Prospect s sole discretion, to substitute up to 100% cash in lieu of such 14.5 million Prospect shares at a price per share based on average trading prices prior to the closing date. As part of the Agreement, the Company contributed its remaining 19.9% interest in its operating subsidiaries to a newly formed limited liability company and then exchanged the interest in this limited liability company for 19.9% of the Company s outstanding common shares held by trusts beneficially owned by the Company s Chief Executive Officer. Further, as part of the Agreement, the remaining non-controlling interest shareholders of the Company entered into an agreement with the Company to exchange all of their outstanding common stock of the Company at a pre-defined price that includes cash and Prospect common, unless the cash option described above is exercised, at which point cash (no stock) will be tendered for the exchange.

The Agreement contains (a) customary representations and warranties of Prospect, the Company and other selling shareholders, including, among others: corporate organization, capitalization, power and authority, governmental approvals and filings, reports and regulatory matters, financial statements, taxes and tax returns, intellectual property rights, contracts and insurance; (b) covenants of the Company to conduct its business in the ordinary course until the sell is completed; (c) covenants of Prospect and the Company not to take certain actions during such interim period; and (d) covenants of the Company to cooperate with financing. The Company and signing shareholders have agreed to indemnify Prospect against certain matters including, among others, breaches of certain representations and warranties and adverse regulatory developments (subject to an earn-back provision).

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NOTE 17 SUBSEQUENT EVENTS (Continued)

Consummation of the sale is expected to close within 60 to 120 days and is subject to certain conditions, including but not limited to regulatory approvals, accuracy of the representations and warranties of the other party and compliance by the other party with its obligations under the Agreement.

After the consummation of the sale, the Company will be a wholly-owned subsidiary of Capitol Street Corporation.

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First Tower Corp. and Subsidiaries

Consolidated Balance Sheets (unaudited)

March 31,		2012		2011
Cash and cash equivalents	$	9,152,875	$	6,972,263
Investment in trading securities		1,129,951		1,048,938
Investment securities available for sale		43,348,852		36,847,235
Finance receivables, net		341,062,995		304,462,509
Prepaid reinsurance premiums		1,943,044		1,793,353
Reinsurance recoverables		1,043,672		993,550
Other receivables		99,454		66,039
Real estate acquired by foreclosure		928,655		891,795
Property and equipment, net		4,717,832		4,649,103
Net deferred income tax asset		13,832,477		13,801,585
Other assets		1,175,755		1,006,722
Total assets	$	418,435,562	$	372,533,092
Notes payable	$	193,881,370	$	176,445,382
Unearned premiums		34,029,478		30,826,393
Policy claim reserves		2,507,128		2,400,567
Accounts payable and accrued expenses		5,633,698		3,579,089
Income taxes payable		5,088,616		4,929,983
Other liabilities		1,152,783		6,119,205
Total liabilities	$	242,293,073	$	224,300,619
Total stockholders equity	$	176,142,489	$	148,232,473
Total liabilities and stockholders equity	$	418,435,562	$	372,533,092

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First Tower Corp. and Subsidiaries

Consolidated Statements of Income and Comprehensive Income (unaudited)

March 31,	2012	2011
Interest and fee income from finance receivables	$ 33,159,738	$ 28,975,557
Insurance premiums	6,436,995	5,735,835
Net investment income	325,570	352,832
Net realized investment gains	106,452	81,710
Other income	1,454,299	1,507,412
Total revenues	41,483,054	36,653,346
Expenses:		
Interest expense	2,208,921	1,948,269
Policyholders benefits	1,178,620	1,107,917
Salaries and fringe benefits	7,845,149	7,129,516
Provision for credit losses	9,707,055	7,610,860
Other operating expenses	5,694,205	5,427,378
Total expenses	26,633,950	23,223,940
Income before taxes	14,849,104	13,429,406
Provision for income taxes	5,870,411	5,243,237
Net income	$ 8,978,693	$ 8,186,169
Other comprehensive income (loss)	(32,247)	(84,137)
Comprehensive income	$ 8,946,446	$ 8,102,032

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First Tower Corp. and Subsidiaries

Consolidated Statements of Cash Flows (unaudited)

March 31,	**2012**	**2011**
Cash flows from operating activities:		
Net income	$ 8,978,693	$ 8,186,169
Depreciation and amortization	324,313	271,101
Deferred income tax provision (benefit)	283,434	200,423
Provision for credit losses	9,707,055	7,610,860
Changes in operating assets and liabilities:		
Prepaid reinsurance premiums & reinsurance recoverables	1,067,361	886,644
Other receivables	414,588	492,547
Real estate acquired by foreclosure	20,025	6,706
Other assets	(454,233)	(390,878)
Unearned premiums	(2,886,729)	(2,167,583)
Policy claim reserves	32,270	33,478
Accounts payable and accrued expenses	(1,999,331)	(1,062,609)
Income taxes payable	3,396,637	3,074,775
Other liabilities	252,124	567,048
Net cash provided / used by operating activities	19,136,207	17,708,682
Cash flows from investing activities:		
Change in finance receivables	19,714,827	13,805,200
Change in investment securities	(3,159,229)	(105,914)
Purchase of property and equipment	(333,003)	(211,010)
Net cash provided / used by investing activities	16,222,595	13,489,276
Cash flows from financing activities:		
Net changes in borrowings	(28,877,612)	(26,353,943)
Dividends paid	(5,123,239)	(3,689,064)
Net cash provided / used by financing activities	(34,000,851)	(30,044,007)
Increase / decrease in cash and cash equivalents	1,357,951	1,153,951
Cash and cash equivalents at beginning of period	7,794,924	5,818,312
Cash and cash equivalents at end of period	$ 9,152,875	$ 6,972,263

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Index to Exhibits

Exhibit Number	Description
23.1	Consent of Independent Auditors