NATIONAL HOLDINGS CORP
Form 10-Q
February 14, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended December 31, 2017	Commission File Number 001-12629

NATIONAL HOLDINGS CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	36-4128138
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

200 Vesey Street, 25th Floor, New York, NY 10281
(Address including zip code of principal executive offices)
Registrant's telephone number, including area code: (212) 417-8000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer (Do not check if a smaller reporting company)	Smaller Reporting Company
	Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 2, 2018 there were 12,437,916 shares of the registrant's common stock outstanding.

NATIONAL HOLDINGS CORPORATION
FORM 10-Q
QUARTERLY PERIOD ENDED DECEMBER 31, 2017

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FORWARD-LOOKING STATEMENTS

The following information provides cautionary statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. We identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements we make in this report or in other documents that reference this report. All statements that express or involve discussions as to: expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, identified through the use of words or phrases such as we or our management believes, expects, anticipates or hopes and words or phrases such as will result, are expected to, will continue, is anticipated, estimated, projection and outlook, and words of similar import) are not statements of historical facts and may be forward-looking. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties including, but not limited to, economic, competitive, regulatory, growth strategies, available financing and other factors discussed elsewhere in this report and in the documents filed by us with the Securities and Exchange Commission ("SEC"). Many of these factors are beyond our control. Actual results could differ materially from the forward-looking statements we make in this report or in other documents that reference this report. In light of these risks and uncertainties, there can be no assurance that the results anticipated in the forward-looking information contained in this report or other documents that reference this report will, in fact, occur.

These forward-looking statements involve estimates, assumptions and uncertainties, and, accordingly, actual results could differ materially from those expressed in the forward-looking statements. These uncertainties include, among others, the following: (i) the inability of our broker-dealer operations to operate profitably in the face of intense competition from larger full service and discount brokers; (ii) a general decrease in merger and acquisition activities and our potential inability to receive success fees as a result of transactions not being completed; (iii) increased competition from business development portals; (iv) technological changes; (v) our potential inability to implement our growth strategy through acquisitions or joint ventures; and (vi) our potential inability to secure additional debt or equity financing.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events, except as required by law. New factors emerge from time to time and it is not possible for our management to predict all of such factors, nor can our management assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statement.

PART I. FINANCIAL INFORMATION
ITEM I. FINANCIAL STATEMENTS

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31, 2017 (Unaudited)	September 30, 2017
ASSETS		
Cash	$24,318,000	$23,508,000
Restricted cash	1,382,000	1,381,000
Cash deposits with clearing organizations	1,041,000	1,041,000
Securities owned, at fair value	8,110,000	7,102,000
Receivables from broker-dealers and clearing organizations	3,243,000	2,850,000
Forgivable loans receivable	1,534,000	1,616,000
Other receivables, net	4,859,000	5,180,000
Prepaid expenses	2,913,000	2,490,000
Fixed assets, net	2,273,000	2,397,000
Intangible assets, net	5,162,000	4,843,000
Goodwill	5,217,000	5,217,000
Deferred tax asset, net	4,102,000	6,420,000
Other assets, principally refundable deposits	335,000	353,000
Total Assets	$64,489,000	$64,398,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Securities sold, but not yet purchased, at fair value	$—	$151,000
Accrued commissions and payroll payable	10,713,000	10,065,000
Accounts payable and accrued expenses	8,776,000	8,715,000
Deferred clearing and marketing credits	733,000	786,000
Warrants issued (Note 19)	11,194,000	5,597,000
Other	1,952,000	181,000
Total Liabilities	33,368,000	25,495,000
Stockholders' Equity		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; none outstanding	—	—
Common stock $0.02 par value, authorized 75,000,000 shares at December 31, 2017 and September 30, 2017; 12,437,916 shares issued and outstanding at December 31, 2017 and September 30, 2017	248,000	248,000
Additional paid-in-capital	67,213,000	66,955,000
Accumulated deficit	(36,355,000)	(28,315,000)
Total National Holdings Corporation Stockholders' Equity	31,106,000	38,888,000
Non-Controlling interest	15,000	15,000
Total Stockholders' Equity	31,121,000	38,903,000
Total Liabilities and Stockholders' Equity	$64,489,000	$64,398,000

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Month Period Ended December 31, 2017	2016
Revenues		
Commissions	$25,618,000	$24,506,000
Net dealer inventory gains	905,000	2,545,000
Investment banking	14,547,000	9,692,000
Investment advisory	5,333,000	3,385,000
Interest and dividends	631,000	716,000
Transaction fees and clearing services	2,297,000	2,498,000
Tax preparation and accounting	523,000	856,000
Other	226,000	371,000
Total Revenues	50,080,000	44,569,000
Operating Expenses		
Commissions, compensation and fees	43,561,000	37,258,000
Clearing fees	743,000	738,000
Communications	760,000	722,000
Occupancy	955,000	1,008,000
License and registration	637,000	405,000
Professional fees	1,393,000	1,263,000
Interest	2,000	4,000
Depreciation and amortization	379,000	295,000
Other administrative expenses	1,826,000	1,230,000
Total Operating Expenses	50,256,000	42,923,000
(Loss) Income before Other Income (Expense) and Income Taxes	(176,000)	1,646,000
Other (Expense) Income		
Change in fair value of warrant liability (Note 19)	(5,597,000)	4,092,000
Other income	6,000	—
Total Other (Expense) Income	(5,591,000)	4,092,000
(Loss) Income before Income Taxes	(5,767,000)	5,738,000
Income tax expense	2,273,000	679,000
Net (Loss) Income	$(8,040,000)	$5,059,000
Net (loss) income per share - Basic	$(0.65)	$0.41
Net (loss) income per share - Diluted	$(0.65)	$0.41
Weighted average number of shares outstanding - Basic	12,437,916	12,437,916
Weighted average number of shares outstanding - Diluted	12,437,916	12,438,474

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)
FOR THE THREE MONTHS ENDED DECEMBER 31, 2017

	Common Stock		Additional Paid-in-Capital	Accumulated Deficit	Non-Controlling Interest	Total Stockholders' Equity
	Shares	$				
Balance, September 30, 2017	12,437,916	$248,000	$66,955,000	$(28,315,000)	$ 15,000	$38,903,000
Stock-based compensation for restricted stock units			258,000			258,000
Net loss				(8,040,000)		(8,040,000)
Balance, December 31, 2017	12,437,916	$248,000	$67,213,000	$(36,355,000)	$ 15,000	$31,121,000

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	For The Three Month Period Ended December 31, 2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$(8,040,000)	$5,059,000
Adjustments to reconcile net (loss) income to net cash provided by operating activities		
Change in fair value of warrant liability	5,597,000	(4,092,000)
Depreciation and amortization	379,000	295,000
Amortization of forgivable loans to registered representatives	160,000	201,000
Stock-based compensation	258,000	—
Provision (recovery) for doubtful accounts	20,000	(115,000)
Amortization of deferred clearing credit	(53,000)	(52,000)
Increase in fair value of contingent consideration payable	4,000	7,000
Deferred tax expense	2,318,000	268,000
Changes in assets and liabilities		
Restricted cash	(1,000)	—
Cash deposits with clearing organizations	—	—
Securities owned, at fair value	(1,008,000)	1,151,000
Receivables from broker-dealers and clearing organizations	(393,000)	499,000
Forgivable loans receivable	(78,000)	(17,000)
Other receivables, net	276,000	1,677,000
Prepaid expenses	(423,000)	56,000
Other assets, principally refundable deposits	18,000	1,000
Accounts payable, accrued expenses and other liabilities	2,062,000	(3,999,000)
Securities sold, but not yet purchased, at fair value	(151,000)	(297,000)
Net cash provided by operating activities	945,000	642,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of businesses	(124,000)	(19,000)
Purchase of fixed assets	(36,000)	(141,000)
Collection on notes receivable	25,000	—
Net cash used in investing activities	(135,000)	(160,000)
NET INCREASE IN CASH	810,000	482,000
CASH BALANCE		
Beginning of the period	23,508,000	21,694,000
End of the period	$24,318,000	$22,176,000

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$2,000	$4,000
Income taxes	$13,000	$81,000
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Fixed assets (acquired but not paid)	$9,000	$23,000
Business acquired:		
Identifiable intangible asset acquired	$529,000	$211,000
Contingent consideration payable	(405,000)	(192,000)
Cash paid	$124,000	$19,000

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2017
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of the Company, have been prepared in accordance with generally accepted accounting principles in the United States (“GAAP”) for interim financial statements and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The condensed consolidated financial statements as of December 31, 2017 and for the three months ended December 31, 2017 and 2016 are unaudited. The results of operations for the interim periods are not necessarily indicative of the results of operations for the respective fiscal years. The consolidated statement of financial condition at September 30, 2017 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by GAAP for complete financial statement presentation. The accompanying consolidated financial information should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017 for additional disclosures and accounting policies.

Certain items in the condensed consolidated statement of operations for the fiscal 2017 period have been reclassified to conform to the presentation in the fiscal 2018 period. Such reclassifications did not have a material impact on the presentation of the overall financial statements.

NOTE 2. ORGANIZATION AND DESCRIPTION OF BUSINESS

National Holdings Corporation (“National” or the “Company”), a Delaware corporation organized in 1996, operates through its wholly owned subsidiaries which principally provide financial services. Through its broker-dealer and investment advisory subsidiaries, the Company (1) offers full service retail brokerage and investment advisory services to individual, corporate and institutional clients, (2) provides investment banking, merger, acquisition and advisory services to micro, small and mid-cap high growth companies, (3) engages in trading securities, including making markets in micro and small-cap, NASDAQ and other exchange listed stocks and (4) provides liquidity in the United States Treasury marketplace. Broker-dealer subsidiaries consist of National Securities Corporation (“National Securities” or “NSC”) and vFinance Investments, Inc. (“vFinance Investments”) (collectively, the “Broker-Dealer Subsidiaries”). The Broker-Dealer Subsidiaries conduct a national securities brokerage business through their main offices in New York City, New York, Boca Raton, Florida, and Seattle, Washington. Broker-dealer subsidiaries are introducing brokers and clear all transactions through clearing organizations, on a fully disclosed basis. The Broker-Dealer Subsidiaries are registered with the Securities and Exchange Commission ("SEC") and the Commodities and Futures Trading Commission, and are members of the Financial Industry Regulatory Authority ("FINRA"), the Securities Investor Protection Corporation and the National Futures Association.

The Company’s wholly-owned subsidiary, National Asset Management, Inc. ("NAM"), is a federally-registered investment adviser providing asset management advisory services to retail clients for a fee based upon a percentage of assets managed.

The Company’s wholly-owned subsidiaries, National Insurance Corporation ("National Insurance") and Prime Financial Services ("Prime Financial"), provide fixed insurance products to their clients, including life insurance, disability insurance, long term care insurance and fixed annuities.

The Company’s wholly-owned subsidiary, Gilman Ciocia, Inc. ("Gilman"), provides tax preparation and accounting services to individuals and small to midsize companies.

The Company’s wholly-owned subsidiary, GC Capital Corporation ("GC"), provides licensed mortgage brokerage services in New York and Florida.

On September 9, 2016, a subsidiary of Fortress Biotech, Inc. (“Fortress”), acquired a controlling interest in the Company. See Note 19.

NOTE 3. RECEIVABLES FROM BROKER-DEALERS AND CLEARING ORGANIZATIONS AND OTHER RECEIVABLES

At December 31, 2017 and September 30, 2017, the receivables of $3,243,000 and $2,850,000, respectively, from broker-dealers and clearing organizations represent net amounts due for fees and commissions associated with the Company's retail brokerage business as well as asset based fee revenues associated with the Company's Investment advisory business.

Other receivables at December 31, 2017 and September 30, 2017 consist of the following:

	December 31, 2017	September 30, 2017
Trailing fees	$857,000	$1,156,000
Accounts receivable for tax and accounting services	444,000	698,000
Allowance for doubtful accounts - tax and accounting services	(279,000)	(390,000)
Advances to registered representatives	825,000	881,000
Allowance for doubtful accounts - advances to registered representatives	(284,000)	(154,000)
Investment banking receivable	1,289,000	1,086,000
Advisory fees	484,000	510,000
Notes receivable	651,000	676,000
Other	872,000	717,000
Total	$4,859,000	$5,180,000

NOTE 4. FORGIVABLE LOANS RECEIVABLE

From time to time, the Company's operating subsidiaries may make loans, evidenced by promissory notes, primarily to newly recruited independent financial advisors as an incentive for their affiliation. The notes receivable balance is comprised of unsecured non-interest-bearing and interest-bearing loans (weighted average interest rate of 4%). These notes have various schedules for repayment or forgiveness based on production or retention requirements being met and mature at various dates through 2022. Forgiveness of loans amounted to $160,000 and $201,000 for the three months ended December 31, 2017 and 2016, respectively, and the related compensation was included in commissions, compensation and fees in the condensed consolidated statements of operations. In the event the advisor's affiliation with the subsidiary terminates, the advisor is required to repay the unamortized balance of any notes payable.

The Company provides an allowance for doubtful accounts on the notes based on historical collection experience and continually evaluates the receivables for collectability and possible write-offs where a loss is deemed probable. As of December 31, 2017 and September 30, 2017, no allowance for doubtful accounts was required.

Forgivable loan activity for the three months ended December 31, 2017 is as follows:

Balance, September 30, 2017	$1,616,000
Additions	78,000
Amortization	(160,000)
Balance, December 31, 2017	$1,534,000

There were no unamortized loans outstanding at December 31, 2017 and September 30, 2017 attributable to registered representatives who ended their affiliation with the Broker-Dealer Subsidiaries prior to the fulfillment of their obligation.

NOTE 5. FAIR VALUE OF ASSETS AND LIABILITIES

Authoritative accounting guidance defines fair value, establishes a framework for measuring fair value, and establishes a fair value hierarchy which prioritizes the inputs to valuation techniques. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. Valuation techniques that are consistent with the market or income approach are used to measure fair value.

The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 - Inputs other than quoted market prices that are observable, either directly or indirectly, and reasonably available. Observable inputs reflect the assumptions market participants would use in pricing the asset or liability and are developed based on market data obtained from sources independent of the Company.

Level 3 - Unobservable inputs which reflect the assumptions that the Company develops based on available information about what market participants would use in valuing the asset or liability.

The following tables present the carrying values and estimated fair values at December 31, 2017 and September 30, 2017 of financial assets and liabilities, excluding financial instruments that are carried at fair value on a recurring basis, and information is provided on their classification within the fair value hierarchy. Such instruments are carried at amounts that approximate fair value due to their short-term nature and generally negligible credit risk.

	December 31, 2017			
Assets	Carrying Value	Level 1	Level 2	Total Estimated Fair Value
Cash	$24,318,000	$24,318,000	$—	$24,318,000
Cash deposits with clearing organizations	1,041,000	1,041,000	—	1,041,000
Receivables from broker-dealers and clearing organizations	3,243,000	—	3,243,000	3,243,000
Forgivable loans receivable	1,534,000	—	1,534,000	1,534,000
Other Receivables, net	4,859,000	—	4,859,000	4,859,000
	$34,995,000	$25,359,000	$9,636,000	$34,995,000
Liabilities				
Accrued commissions and payroll payable	$10,713,000	$—	$10,713,000	$10,713,000
Accounts payable and accrued expenses (1)	8,059,000	—	8,059,000	8,059,000
	$18,772,000	$—	$18,772,000	$18,772,000

(1) Excludes contingent consideration liabilities of $717,000.

	September 30, 2017			
Assets	Carrying Value	Level 1	Level 2	Total Estimated Fair Value
Cash	$23,508,000	$23,508,000	$—	$23,508,000
Cash deposits with clearing organizations	1,041,000	1,041,000	—	1,041,000
Receivables from broker-dealers and clearing organizations	2,850,000	—	2,850,000	2,850,000
Forgivable loans receivable	1,616,000	—	1,616,000	1,616,000
Other Receivables, net	5,180,000	—	5,180,000	5,180,000
	$34,195,000	$24,549,000	$9,646,000	$34,195,000
Liabilities				
Accrued commissions and payroll payable	$10,065,000	$—	$10,065,000	$10,065,000
Accounts payable and accrued expenses (1)	8,404,000	—	8,404,000	8,404,000

	$18,469,000	$—	$18,469,000	$18,469,000

(1) Excludes contingent consideration liabilities of $311,000.

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The following tables present the financial assets and liabilities measured at fair value on a recurring basis at December 31, 2017 and September 30, 2017:

	December 31, 2017				
Assets	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Securities owned:					
Corporate stocks	$65,000	$65,000	$—	$—	$65,000
Municipal bonds	3,452,000	3,452,000	—	—	3,452,000
Restricted stock	75,000	—	75,000	—	75,000
Warrants	4,518,000	—	4,518,000	—	4,518,000
	$8,110,000	$3,517,000	$4,593,000	$—	$8,110,000
Liabilities					
Contingent consideration	$717,000	$—	$—	$717,000	$717,000
Warrants issued	11,194,000	—	11,194,000	—	11,194,000
	$11,911,000	$—	$11,194,000	$717,000	$11,911,000

	September 30, 2017				
Assets	Carrying Value	Level 1	Level 2	Level 3	Total Estimated Fair Value
Securities owned:					
Corporate stocks	$116,000	$116,000	$—	$—	$116,000
Municipal bonds	1,239,000	1,239,000	—	—	1,239,000
Restricted stock	82,000	—	82,000	—	82,000
Warrants	5,665,000	—	5,665,000	—	5,665,000
	$7,102,000	$1,355,000	$5,747,000	$—	$7,102,000
Liabilities					
Contingent consideration	$311,000	$—	$—	$311,000	$311,000
Warrants issued	5,597,000	—	5,597,000	—	5,597,000
Securities sold, but not yet purchased:					
Municipal bonds	151,000	151,000	—	—	151,000
	$6,059,000	$151,000	$5,597,000	$311,000	$6,059,000

Certain positions in common stock and warrants were received as compensation for investment banking services. Restricted common stock and warrants may be freely traded only upon the effectiveness of a registration statement covering them or upon the satisfaction of the requirements of Rule 144, including the requisite holding period. The unrealized (loss)/gain for the change in fair value of such positions for the three months ended December 31, 2017 and 2016 amounted to approximately $(1,155,000) and $34,000, respectively, which is included in net dealer inventory gains.

Warrants are carried at fair value as determined by using the Black-Scholes option pricing model. This model takes into account the underlying securities current market values, the underlying securities market volatility, the terms of the warrants, exercise prices, and risk-free return rate. The market value of the underlying securities' market value is discounted based on the value of a protective put, which reduces the current market price used as an input into the Black-Scholes option pricing model.

Debt securities are valued based on recently executed transactions.

NOTE 6. FIXED ASSETS

Fixed assets as of December 31, 2017 and September 30, 2017 consist of the following:

	December 31, 2017	September 30, 2017	Estimated Useful Lives
Equipment and software	$ 1,775,000	$ 1,742,000	5
Furniture and fixtures	389,000	382,000	5
Leasehold improvements	1,405,000	1,400,000	Lesser of useful life or term of lease
Capital leases (primarily composed of computer equipment)	739,000	739,000	5
	4,308,000	4,263,000	
Less accumulated depreciation and amortization	(2,035,000)	(1,866,000)	
Fixed assets – net	$ 2,273,000	$ 2,397,000	

Depreciation expense associated with fixed assets for the three months ended December 31, 2017 and 2016 was $169,000 and $98,000, respectively.

NOTE 7. BUSINESS COMBINATIONS AND CONTINGENT CONSIDERATION

Business Combination

In October and November 2017, Gilman acquired certain assets of four tax preparation and accounting businesses that were deemed to be business acquisitions. The consideration for the transactions consisted of cash payments at closing totaling $124,000 and contingent consideration payables in cash having a fair value of $405,000, for which liabilities (included in Accounts payable and accrued expenses) were recognized based on the estimated acquisition date fair value of the potential earn-outs. The earn-outs are based on revenue, as defined in the acquisition agreements, during various periods following the closings. The liabilities were valued using an income-based approach using unobservable inputs (Level 3) and reflect the Company’s own assumptions. The liabilities will be revalued at each balance sheet date with changes therein recorded in earnings. The fair values of the acquired assets totaling $529,000 were allocated to customer relationships, which are being amortized over seven years. Results of operations of the acquired businesses are included in the accompanying condensed consolidated statements of operations from the respective dates of acquisition and were not material. In addition, based on materiality, pro forma results are not presented.

Contingent Consideration

Set below are changes in the carrying value of contingent consideration for the three months ended December 31, 2017 related to acquisitions:

Fair value of contingent consideration at September 30, 2017	$ 311,000
Fair value of contingent consideration in connection with above acquisitions	405,000
Payments	(3,000)
Change in fair value	4,000
Fair value of contingent consideration at December 31, 2017	$ 717,000

NOTE 8. INTANGIBLE ASSETS

Intangibles consisted of the following at December 31, 2017 and September 30, 2017:

	December 31, 2017			
Intangible asset	Cost	Accumulated Amortization	Carrying Value	Estimated Useful Life (years)
Customer relationships	$7,347,000	$ 2,895,000	$4,452,000	3-10
Gilman brand name	710,000	—	710,000	Indefinite
	$8,057,000	$ 2,895,000	$5,162,000	

	September 30, 2017			
Intangible asset	Cost	Accumulated Amortization	Carrying Value	Estimated Useful Life (years)
Customer relationships	$6,818,000	$ 2,685,000	$4,133,000	3-10
Gilman brand name	710,000	—	710,000	Indefinite
	$7,528,000	$ 2,685,000	$4,843,000	

Amortization expense associated with intangible assets for the three months ended December 31, 2017 and 2016 was $210,000 and $197,000, respectively.

The estimated future amortization expense of the finite lived intangible assets for the next five fiscal years and thereafter is as follows:

Year ending September 30,	
Nine months ending September 30, 2018	$649,000
2019	865,000
2020	795,000
2021	795,000
2022	741,000
Thereafter	607,000
Total	$4,452,000

NOTE 9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES AND OTHER LIABILITIES

Accounts payable and accrued expenses as of December 31, 2017 and September 30, 2017 consist of the following:

	December 31, 2017	September 30, 2017
Legal	$ 653,000	$ 877,000
Audit	171,000	176,000
Telecommunications	208,000	205,000
Data services	454,000	464,000
Regulatory	663,000	540,000
Settlements	1,789,000	2,403,000
Contingent consideration payable	717,000	311,000
Deferred rent	684,000	497,000

Other	3,437,000	3,242,000
Total	$ 8,776,000	$ 8,715,000

Other liabilities primarily consist of $1,804,000 due to broker-dealer for open security positions held at December 31, 2017. No amount was due to broker-dealer at September 30, 2017.

NOTE 10. PER SHARE DATA

Basic net (loss) income per share of common stock attributable to the Company is computed on the basis of the weighted average number of shares of common stock outstanding. Diluted net (loss) income per share is computed on the basis of such weighted average number of shares of common stock outstanding plus the dilutive effect of incremental shares of common stock potentially issuable under outstanding options, warrants and unvested restricted stock units utilizing the treasury stock method. A reconciliation of basic and diluted common shares used in the computation of per share data follows:

	Three Month Period Ended December 31,	
	2017	2016
Basic weighted-average shares	12,437,916	12,437,916
Effect of dilutive securities:		
Options	—	558
Diluted weighted-average shares	12,437,916	12,438,474

The following potential common share equivalents are not included in the above diluted computation because to do so would be anti-dilutive as the instruments are out of the money:

	Three Month Period Ended December 31,	
	2017	2016
Options	624,000	1,202,000
Warrants	12,437,916(a)	21,558
Restricted stock units	77,737	—
	13,139,653	1,223,558

(a) As the warrants are out of the money in the diluted computation, no adjustment is made to net (loss) income to eliminate the change in fair value of the warrants.

NOTE 11. OFF BALANCE SHEET RISK AND CONCENTRATION OF CREDIT RISK

The Company is engaged in trading and providing a broad range of securities brokerage and investment services to a diverse group of retail and institutional clientele, as well as corporate finance and investment banking services to corporations and businesses. Counterparties to the Company's business activities include broker-dealers and clearing organizations, banks and other financial institutions. The Company uses clearing brokers to process transactions and maintain customer accounts for the Company on a fee basis. The Company permits the clearing firms to extend credit to its clientele secured by cash and securities in the client's account. The Company's exposure to credit risk associated with the non-performance by its customers and counterparties in fulfilling their contractual obligations can be directly impacted by volatile or illiquid trading markets, which may impair the ability of customers and counterparties to satisfy their obligations to the Company. The Company has agreed to indemnify the clearing brokers for losses they incur while extending credit to the Company's clients. It is the Company's policy to review, as necessary, the credit standing of its customers and counterparties. Amounts due from customers that are considered uncollectible by the clearing broker are charged back to the Company by the clearing broker when such amounts become determinable. Upon notification of a charge back, such amounts, in total or in part, are then either (i) collected from the customers, (ii) charged to the broker initiating the transaction and/or (iii) charged to operations, based on the particular facts and circumstances.

The Company maintains cash in bank deposits, which, at times, may exceed federally insured limits. The Company has not experienced and does not expect to experience losses on such accounts.

A short sale involves the sale of a security that is not owned in the expectation of purchasing the same security (or a security exchangeable) at a later date at a lower price. A short sale involves the risk of a theoretically unlimited increase in the market price of the security that would result in a theoretically unlimited loss.

NOTE 12. NEW ACCOUNTING GUIDANCE

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, Revenue From Contracts With Customers (Topic 606) which creates a single, principle-based model for revenue recognition and expands and improves disclosures about revenue. The new guidance is effective for the Company beginning October 1, 2018, and must be adopted using either a full retrospective approach for all periods presented in the period of adoption or a modified retrospective approach. The Company is currently evaluating the potential impact of this standard on its financial statements which, (1) for investment banking advisory arrangements may change the timing of revenue recognition depending on the number and nature of the performance obligations identified, (2) for underwriting expenses and costs of advisory services and related reimbursement revenue may need to be recognized on a gross basis, and (3) for costs to obtain and fulfill a contract may need to be capitalized, amortized and reviewed regularly for impairment.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which supersedes the existing guidance for lease accounting, Leases (Topic 840). ASU 2016-02 requires lessees to recognize leases on their balance sheets, and leaves lessor accounting largely unchanged. The amendments in this ASU are effective for the Company beginning October 1, 2019 and interim periods within those fiscal years. Early application is permitted for all entities. ASU 2016-02 requires a modified retrospective approach for all leases existing at, or entered into after, the date of initial application, with an option to elect to use certain transition relief. The Company is currently assessing the impact that the adoption of ASU 2016-02 will have on its financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting”. ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification in the statement of cash flows. ASU 2016-09 was effective for the Company beginning October 1, 2017 for both interim and annual reporting periods. The adoption did not have a significant impact on the Company’s financial statements. The Company had historically estimated the number of forfeitures as part of its share-based accounting and will continue to do so under the new guidance. No aspect of the guidance that requires retrospective adoption impacted the Company.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230) - Classification of Certain Cash Receipts and Cash Payments”. ASU 2016-15 reduces the diversity of how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics. The standard is effective for the Company beginning October 1, 2018 for both interim and annual periods. Early adoption is permitted. The ASU should be applied retrospectively to all periods presented. The Company does not anticipate that the adoption of ASU 2016-15 will have a material impact on its financial statements.

In November 2016, the FASB issued ASU 2016-18, “Statement of Cash Flows (Topic 230) - Restricted Cash”. ASU 2016-18 reduces the diversity in the presentation of restricted cash and restricted cash equivalents in the statement. The statement requires that restricted cash and restricted cash equivalents be included as components of total cash and cash equivalents as presented on the statement of cash flows. The standard is effective for the Company beginning October 1, 2018 for both interim and annual periods. Early adoption is permitted. The ASU should be applied retrospectively to all periods presented. The Company expects that it will present restricted cash as a component of total cash and cash equivalents on the statement of cash flow upon adoption.

In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business”. The amendments in this Update is to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The definition of a business affects many areas of accounting including acquisitions, disposals, goodwill, and consolidation. The standard is effective for the Company beginning October 1, 2018 for both interim and annual periods. The Company is currently assessing the impact that the adoption of ASU 2017-01 will have on its financial statements.

In May 2017, the FASB issued ASU 2017-09, “Scope of Modification Accounting”. This ASU clarifies when changes to the terms or conditions of a share-based payment award must be accounted for as modifications. Under the new guidance, modification accounting is required only if the fair value, the vesting conditions, or the classification of the award (as equity or liability) changes as a result of the change in terms or conditions. The standard is effective for the Company beginning October 1, 2018 for both interim and annual periods. Early adoption is permitted. The Company is currently assessing the impact that the adoption of ASU 2017-09 will have on its financial statements.

NOTE 13. COMMITMENTS AND CONTINGENCIES

Leases

The Company leases office space in various states expiring at various dates through October 2026, and as of December 31, 2017, is committed under operating leases for future minimum lease payments as follows:

Fiscal Year Ending	Lease Payments	Less, Sublease Income	Net
Nine months ending September 30, 2018	$2,580,000	$270,000	$2,310,000
2019	2,731,000	30,000	2,701,000
2020	2,602,000	—	2,602,000
2021	2,241,000	—	2,241,000
2022	1,449,000	—	1,449,000
Thereafter	4,532,000	—	4,532,000
	$16,135,000	$300,000	$15,835,000

The total amount of rent payable under the leases is recognized on a straight line basis over the term of the leases. Rental expense under all operating leases, excluding sublease income, for the three months ended December 31, 2017 and 2016 was $1,040,000 and $995,000, respectively. Sublease income under all operating subleases for the three months ended December 31, 2017 and 2016 was approximately $133,000 and $37,000, respectively.

As of December 31, 2017, the Company and its subsidiaries had three outstanding letters of credit, which have been issued in the maximum amount of $1,382,000 as security for property leases, and which are collateralized by the restricted cash as reflected in the condensed consolidated statements of financial condition.

Litigation and Regulatory Matters

The Company and its subsidiaries are defendants or respondents in various pending and threatened arbitrations, administrative proceedings and lawsuits seeking compensatory damages. Several cases have no stated alleged damages. Claim amounts are infrequently indicative of the actual amounts the Company will be liable for, if any. Further, the Company has a history of collecting amounts awarded in these types of matters from its registered representatives that are still affiliated, as well as from those that are no longer affiliated. Many of these claimants also seek, in addition to compensatory damages, punitive or treble damages, and all seek interest, costs and fees. These matters arise in the normal course of business. The Company intends to vigorously defend itself in these actions, and the ultimate outcome of these matters cannot be determined at this time.

Liabilities for potential losses from complaints, legal actions, government investigations and proceedings are established where the Company believes that it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. In making these decisions, management bases its judgments on its knowledge of the situations, consultations with legal counsel and its historical experience in resolving similar matters. In many lawsuits, arbitrations and regulatory proceedings, it is not possible to determine whether a liability has been incurred or to estimate the amount of that liability until the matter is close to resolution. However, accruals are reviewed regularly and are adjusted to reflect the Company’s estimates of the impact of developments, rulings, advice of counsel and any other information pertinent to a particular matter. Because of the inherent difficulty in predicting the ultimate outcome of legal and regulatory actions, management cannot predict with certainty the eventual loss or range of loss related to such matters. At December 31, 2017 and September 30, 2017, the Company accrued approximately $1,789,000 and $2,403,000, respectively. These amounts are included in accounts payable and accrued expenses in the condensed consolidated statements of financial condition. Amounts charged to operations for settlements and potential losses during the three months ended December 31, 2017 and 2016 were $246,000 and $6,000, respectively, which is included in other administrative expenses. The Company has included in "Professional fees" litigation and FINRA related expenses of $351,000 and $546,000 for the three months ended December 31, 2017 and 2016, respectively.

NOTE 14. NET CAPITAL REQUIREMENTS

National Securities is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1) (the "Rule"), which, among other things, requires the maintenance of minimum net capital. At December 31, 2017, National Securities had net capital of $9,954,024 which was $9,704,024 in excess of its required net capital of $250,000. National Securities is exempt from the provisions of the SEC's Rule 15c3-3 since it is an introducing broker-dealer that clears all transactions on a fully disclosed basis and promptly transmits all customer funds and securities to clearing brokers.

vFinance Investments is also subject to the Rule, which, among other things, requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2017, vFinance Investments had net capital of $1,153,017 which was $153,017 in excess of its required net capital of $1,000,000. vFinance Investments' ratio of aggregate indebtedness to net capital was 2.5 to 1. vFinance Investments is exempt from the provisions of the SEC's Rule 15c3-3 since it is an introducing broker-dealer that clears all transactions on a fully disclosed basis and promptly transmits all customer funds and securities to clearing brokers.

Advances, dividend payments and other equity withdrawals from the Company's Broker-Dealer Subsidiaries are restricted by the regulations of the SEC, and other regulatory agencies. These regulatory restrictions may limit the amounts that a subsidiary may dividend or advance to the Company.

NOTE 15. STOCKHOLDERS' EQUITY

Stock Options

Information with respect to stock option activity during the three months ended December 31, 2017 follows:

	Options	Weighted Average Exercise Price Per Share	Weighted Average Grant-Date Fair Value Per Share	Weighted Average Remaining Contractual term (years)	Aggregate Intrinsic Value
Outstanding at September 30, 2017	1,206,000	$ 6.54	$ 1.21	2.29	$ —
Expired	(582,000)	$ 6.93	$ 0.81		
Outstanding at December 31, 2017	624,000	$ 6.17	$ 1.59	3.94	$ —
Vested and exercisable at December 31, 2017	624,000	$ 6.17	$ 1.59	3.94	$ —

As of September 30, 2016, all compensation expense associated with the grants of stock options had been recognized.

Warrants

The following table summarizes information about warrant activity during the three months ended December 31, 2017:

	Warrants	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term
Outstanding at September 30, 2017	12,439,387	$ 3.25	4.30
Forfeited or expired	(1,471)	$ 5.00	

Outstanding and exercisable at December 31, 2017	12,437,916	$ 3.25	4.05

Restricted Stock Units

A summary of the Company's non-vested restricted stock units for the three months ended December 31, 2017 is as follows:

	Shares	Weighted Average Grant Due Fair Value
Non-vested restricted stock units at September 30, 2017	1,250,000	$3,054,000
Granted	—	—
Vested	—	—
Non-vested restricted stock units at December 31, 2017	1,250,000	$3,054,000

For the three months ended December 31, 2017, the Company recognized compensation expense of $258,000 related to restricted stock units ("RSU"). At December 31, 2017, unrecognized compensation with respect to RSUs amounted to $2,194,000, assuming all performance-based compensation will vest.

NOTE 16. SHARE REPURCHASE

In August 2015, the Company's Board of Directors authorized the repurchase of up to $2 million of the Company's common stock. Share repurchases, if any, will be made using a variety of methods, which may include open market purchases, privately negotiated transactions or block trades, or any combination of such methods, in accordance with applicable insider trading and other securities laws and regulations. The Company's Board did not stipulate an expiration date for this repurchase and the purchase decisions are at the discretion of the Company's management. During the three months ended December 31, 2017 and 2016, the Company did not repurchase any shares.

NOTE 17. INCOME TAXES

The Company files a consolidated federal income tax return and certain combined state and local income tax returns with its subsidiaries. Income taxes for the three month period ended December 31, 2017 and 2016 is based on the estimated annual effective tax rate. Each quarter the Company updates its estimate of the annual effective tax rate and records cumulative adjustments as necessary.

The effective tax rate for the three month period ended December 31, 2017 and 2016 differs from the federal statutory income tax rate principally due to non-deductible expenses, state and local income taxes and non-taxable changes in the fair value of warrant liability.

During the three month period ended December 31, 2017, the Company estimated its annual effective rate to reflect a change in the federal statutory rate from 34% to 21%, resulting from legislation enacted on December 22, 2017. The rate change is administered effective at the beginning of the Company's fiscal year, using a blended rate for the annual period of 24.28%. Additionally, the Company recognized a tax expense of approximately $2,200,000 during the three month period ended December 31, 2017 to adjust the Company's net deferred tax balance to reflect the new corporate tax rate. The accounting for the effects of the rate change on deferred tax balances is complete and no provisional amounts were recorded for this item.

At December 31, 2017, the Company's net deferred tax asset is principally comprised of net operating loss carryforwards. Management believes that is more likely than not that its deferred tax assets will be realized and, accordingly, has not provided a valuation allowance against such amount.

NOTE 18. SEGMENT INFORMATION

The Company has two reportable segments. The brokerage and advisory services segment includes broker-dealer and investment advisory services, the sale of insurance products and licensed mortgage brokerage services provided by the Broker-Dealer Subsidiaries, NAM, National Insurance, Prime Financial and GC. The tax and accounting services segment includes tax preparation and accounting services provided by Gilman.

The Corporate pre-tax income (loss) consists of certain items that have not been allocated to reportable segments.

Segment information for the three months ended December 31, 2017 and 2016 is as follows:

	Brokerage and Advisory Services	Tax and Accounting Services	Corporate	Total
Three Months Ended December 31, 2017				
Revenues	$49,557,000	$523,000	$ —	$50,080,000
Pre-tax income (loss)	1,574,000	(992,000)	(6,349,000) (a)	(5,767,000)
Assets	50,390,000	2,589,000	11,510,000 (b)	64,489,000
Depreciation and amortization	186,000	58,000	135,000	379,000
Interest	2,000	—	—	2,000
Capital expenditures	39,000	6,000	—	45,000
2016				
Revenues	$43,713,000	$856,000	$ —	$44,569,000
Pre-tax income (loss)	3,096,000	(712,000)	3,354,000 (c)	5,738,000
Assets	41,543,000	1,911,000	13,933,000 (b)	57,387,000
Depreciation and amortization	158,000	48,000	89,000	295,000
Interest	4,000	—	—	4,000
Capital expenditures	19,000	48,000	97,000	164,000

(a) Consists of loss on the change in fair value of warrant liability and executive salaries and other expenses not allocated to reportable segments by management.

(b) Consists principally of deferred tax assets, cash, prepaid and fixed asset balances held at Corporate.

(c) Consists of gain on the change in fair value of warrant liability offset in part by executive salaries and other expenses not allocated to reportable segments by management.

NOTE 19. ACQUISITION OF CONTROLLING INTEREST IN THE COMPANY AND WARRANT LIABILITY

On September 12, 2016, FBIO Acquisition, Inc. (“FBIO Acquisition”), a wholly-owned subsidiary of Fortress, completed a tender offer (the “Offer”) for all outstanding shares of the Company at a price of $3.25 per share, net to the seller in cash (less any required withholding taxes and without interest) (the “Offer Price”), pursuant to the terms of an Agreement and Plan of Merger dated as of April 27, 2016 (as amended, the “Merger Agreement”) among the Company, Fortress and FBIO Acquisition. The Offer expired on September 9, 2016, and a total of 7,037,482 shares were validly tendered and not withdrawn (including shares delivered through notices of guaranteed delivery), representing approximately 56.6% of the Company's issued and outstanding shares of common stock immediately following the completion of the Offer (in each case, without giving effect to the issuance or exercise of the Dividend Warrants). On September 12, 2016, FBIO Acquisition accepted for payment all shares that were validly tendered and not withdrawn prior to the expiration time of the Offer and delivered payment for such shares.

Dividend Warrants

In accordance with the Merger Agreement, since less than 80% of the Company's issued and outstanding shares of common stock were tendered, the Company remains a publicly-traded company and stockholders post-tender offer received from the Company a five year warrant per held share to purchase an additional share of the Company's common stock at $3.25 as a dividend to all holders of the Company's common stock.

As the Company does not have the ability to settle the warrants with unregistered shares and maintenance of an effective registration statement (which did not exist at September 30, 2016) may be considered outside of the Company’s control, net cash settlement of the warrants is assumed. Accordingly, as the Company was obligated to issue the warrants at September 30, 2016, and subsequently issued the warrants in January 2017, the fair value of the 12,437,916 warrants are being classified as a liability in the condensed consolidated statement of financial condition at December 31, 2017 and September 30, 2017. This liability is subject to re-measurement at each balance sheet date until the warrants are exercised or expired, and any change in fair value is recognized as “change in fair value of warrant liability” in the condensed consolidated statements of operations. As the warrants were registered and the Company maintained an effective registration statement at December 31, 2017 and September 30, 2017, fair value of the warrants was based on the market price. The (loss)/gain for the change in fair value of the warrants for the three months ended December 31, 2017 and 2016 amounted to $(5,597,000) and $4,092,000, respectively.

NOTE 20. RELATED PARTY TRANSACTIONS

During the three months ended December 31, 2017 and 2016, Investment Banking revenues include approximately $1,298,000 and $2,665,000, respectively, of fees related to placement of securities for Fortress and subsidiaries of Fortress.

NOTE 21. VARIABLE INTEREST ENTITIES

The Company has entered into agreements to provide investment banking and advisory services to numerous entities that are
variable interest entities ("VIEs") under the accounting guidance. As the fee arrangements under such agreements are arm's-length and contain customary terms and conditions and represent compensation that is considered fair value for the services
provided, the fee arrangements are not considered variable interests and accordingly, the Company does not consolidate such VIEs. Fees attributable to such arrangements for the three months ended December 31, 2017 and 2016 were $6,216,000 and $3,054,000, respectively.

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

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Report may contain certain statements of a forward-looking nature relating to future events or future business performance. Any such statements that refer to our estimated or anticipated future results or other non-historical facts are forward-looking and reflect our current perspective of existing trends and information. These statements involve risks and uncertainties that cannot be predicted or quantified and, consequently, actual results may differ materially from those expressed or implied by such forward-looking statements. Such risks and uncertainties include, among others, risks and uncertainties detailed under the section titled "Risks Factors" of our Form 10-K for the year ended September 30, 2017. Any forward-looking statements contained in or incorporated into this Quarterly Report on Form 10-Q speak only as of the date of this Report. We undertake no obligation to update publicly any forward-looking statement, whether as a result of new information, future events or otherwise, except as required by law.

OVERVIEW

We are engaged in independent brokerage and advisory services and asset management services, investment banking, equity research and institutional sales and trading, through our Broker-Dealer Subsidiaries, National Securities and vFinance Investments. We are committed to establishing a significant presence in the financial services industry by meeting the varying investment needs of our retail, corporate and institutional clients. Our wholly-owned subsidiary, NAM, is a federally-registered investment adviser that provides asset management advisory services to clients for a fee based upon a percentage of assets managed. We also provide tax preparation services through Gilman, which provides tax preparation services to individuals, predominantly in the middle and upper income tax brackets and accounting services to small and midsize companies.

Each of our Broker-Dealer Subsidiaries is subject to regulation by, among others, the SEC, FINRA and the Municipal Securities Rulemaking Board ("MSRB"), and are members of the Securities Investor Protection Corporation ("SIPC") and the National Futures Association ("NFA"). In addition, each of the Broker-Dealer Subsidiaries is licensed to conduct its brokerage activities in all 50 states, plus the District of Columbia and Puerto Rico and the U.S. Virgin Islands. Gilman is also subject to regulation by, among others, the Internal Revenue Service.

As of December 31, 2017, we had approximately 1,009 associated personnel serving retail and institutional customers, trading and investment banking clients. In addition to our 27 Company offices located in New York, New Jersey, Florida, Texas and Washington, we had approximately 100 other registered offices, owned and operated by independent owners who maintain all appropriate licenses and are responsible for all office overhead and expenses.

Our registered representatives offer a broad range of investment products and services. These products and services allow us to generate both commissions (from transactions in securities and other investment products) and fee income (for providing investment advisory services, namely managing clients' accounts). The investment products and services offered include but are not limited to stocks, bonds, mutual funds, annuities, insurance, and managed money accounts.

RESULTS OF OPERATIONS

Three Months Ended December 31, 2017 Compared to Three Months Ended December 31, 2016

Summary

Our first quarter ended December 31, 2017 resulted in 12% increase in revenues and 17% increase in operating expenses. Investment banking continued to provide high demand deals that were sold across various industry segments in conjunction with favorable market conditions. Our trading business was mainly affected by the uncertainty in the fixed income markets due to the new tax reform laws that had been pending during the quarter. Volumes were low and new municipal offerings were weak leading to diminished trading opportunities.

Revenues

Total revenues increased $5,511,000, or 12%, to $50,080,000, in the current quarter as compared to $44,569,000 recorded in the comparative period last year.

	Three Months Ended December 31,		Increase (Decrease)	
	2017	2016	Amount	Percent
Commissions	$25,618,000	$24,506,000	$1,112,000	5 %
Net dealer inventory gains	905,000	2,545,000	(1,640,000)	(64)
Investment banking	14,547,000	9,692,000	4,855,000	50
Investment advisory	5,333,000	3,385,000	1,948,000	58
Interest and dividends	631,000	716,000	(85,000)	(12)
Transaction fees and clearing services	2,297,000	2,498,000	(201,000)	(8)
Tax preparation and accounting	523,000	856,000	(333,000)	(39)
Other	226,000	371,000	(145,000)	(39)
Total Revenues	$50,080,000	$44,569,000	$5,511,000	12 %

Commissions increased $1,112,000, or 5%, to $25,618,000 in the current quarter as compared to $24,506,000 recorded in the comparative period last year. Retail commissions increased this quarter primarily due to favorable markets;

Net dealer inventory gains, decreased $1,640,000, or 64%, to $905,000 in the current quarter as compared to $2,545,000 recorded in the comparative period last year. This decrease is mainly related to the unrealized loss for the change in fair
value of the warrants received from investment banking deals;

Investment banking fees increased $4,855,000, or 50%, to $14,547,000 in the current quarter as compared to $9,692,000 recorded in the comparative period last year. Increased product offerings and issuers produced a strong deal pipeline, which yielded strong investment opportunities for our clients;

Investment advisory fees increased $1,948,000, or 58%, to $5,333,000 in the current quarter as compared to $3,385,000 recorded in the comparative period last year. A net increase in assets under management and stronger equity markets drove the increase;

Interest and dividend income decreased $85,000, or 12%, to $631,000 in the current quarter as compared to $716,000 recorded in the comparative period last year;

Transaction fees and clearing services decreased $201,000, or 8%, to $2,297,000 in the current quarter as compared to $2,498,000 recorded in the comparative period last year;

Tax preparation and accounting fees decreased $333,000, or 39%, to $523,000 in the current quarter as compared to $856,000 recorded in the comparative period last year. This decrease is attributable to fewer extensions filed in the current quarter as compared to the prior period;

Other revenue decreased $145,000, or 39%, to $226,000 in the current quarter as compared to $371,000 recorded in the comparative period last year. This decrease is due to a decline of client participation in our fully paid stock lending program;

Operating Expenses

Total operating expenses increased $7,333,000, or 17%, to $50,256,000 in the current quarter as compared to $42,923,000 recorded in the comparative period last year.

	Three Months Ended December 31,		Increase (Decrease)	
	2017	2016	Amount	Percent
Commissions, compensation and fees	$43,561,000	$37,258,000	$6,303,000	17 %
Clearing fees	743,000	738,000	5,000	1
Communications	760,000	722,000	38,000	5
Occupancy	955,000	1,008,000	(53,000)	(5)
License and registration	637,000	405,000	232,000	57
Professional fees	1,393,000	1,263,000	130,000	10
Interest	2,000	4,000	(2,000)	(50)
Depreciation and amortization	379,000	295,000	84,000	28
Other administrative expenses	1,826,000	1,230,000	596,000	48
Total Operating Expenses	$50,256,000	$42,923,000	$7,333,000	17 %

Commissions, compensation, and fees increased $6,303,000, or 17%, to $43,561,000 in the current quarter as compared to $37,258,000 recorded in the comparative period last year. Commissions, compensation, and fees includes expenses based on commission revenue earned, net dealer inventory gains and investment banking revenues, as well as compensation to our non-broker employees. The increase in investment banking revenue was primarily responsible for the increase in this expense category. In addition, new strategic hires in technology and enterprise risk management and increases in benefits expenses also contributed to the increase;

Clearing fees increased $5,000, or 1%, to $743,000 in the current quarter as compared to $738,000 recorded in the comparative period last year;

Communications expenses increased $38,000, or 5%, to $760,000 in the current quarter as compared to $722,000 recorded in the comparative period last year;

Occupancy expenses decreased $53,000, or 5%, to $955,000 in the current quarter as compared to $1,008,000 recorded in the comparative period last year;

License and registration expense increased by $232,000, or 57%, to $637,000 in the current quarter as compared to $405,000 recorded in the comparative period last year. This increase is attributable to licenses for software applications as the Company continues to invest in and implement technology enhancements;

Professional fees increased by $130,000, or 10% to $1,393,000 in the current quarter as compared to $1,263,000 recorded in the comparative period last year. This increase is also associated with technology implementation;

Interest expense decreased by $2,000, to $2,000 in the current quarter as compared to $4,000 recorded in the comparative period last year;

Depreciation and amortization expenses increased $84,000, or 28% to $379,000 in the current quarter as compared to $295,000 recorded in the comparative period last year;

Other administrative expenses increased $596,000, or 48%, to $1,826,000 in the current quarter as compared to $1,230,000 recorded in the comparative period last year. This increase is attributable to higher provisions for potential arbitration settlements, technology spending and higher insurance costs;

NON-GAAP INFORMATION

Management considers earnings before interest, taxes, depreciation and amortization, or EBITDA, as adjusted, an important indicator in evaluating our business on a consistent basis across various periods. Due to the significance of non-recurring items, EBITDA, as adjusted, enables our Board of Directors and management to monitor and evaluate our business on a consistent basis. We use EBITDA, as adjusted, as a primary measure, among others, to analyze and evaluate financial and strategic planning decisions regarding future operating investments and potential acquisitions. We believe that EBITDA, as adjusted, eliminates items that are not part of our core operations, such as interest expense and amortization expense associated with intangible assets, or items that do not involve a cash outlay, such as stock-related compensation. EBITDA, as adjusted should be considered in addition to, rather than as a substitute for pre-tax income, net income and cash flows from operating activities.

For the three months ended December 31, 2017 and 2016, EBITDA, as adjusted, was $629,000 and $2,146,000, respectively. The decrease of $1,517,000, or 71% resulted primarily from the unrealized loss on our warrant portfolio, and higher operating expenses recognized over the comparative period last year. These expenses were due to investments in people and technology.

The following table presents a reconciliation of EBITDA, as adjusted, to net income as reported in accordance with generally accepted accounting principles, or GAAP:

	Three Months Ended December 31,	
	2017	2016
Net (loss) income, as reported	$(8,040,000)	$5,059,000
Interest expense	2,000	4,000
Income taxes	2,273,000	679,000
Depreciation	169,000	98,000
Amortization	210,000	197,000
EBITDA	(5,386,000)	6,037,000
Non-cash compensation expense	258,000	—
Change in fair value of warrant liability	5,597,000	(4,092,000)
Forgivable loan amortization	160,000	201,000
EBITDA, as adjusted	$629,000	$2,146,000

EBITDA, adjusted for forgivable loan amortization, non-cash compensation expense and other non-recurring items, is a key metric we use in evaluating our business. EBITDA is considered a non-GAAP financial measure as defined by Regulation G, promulgated by the SEC.

Liquidity and Capital Resources

	Ending Balance at December 31,		Average Balance during first three months of	
	2017	2016	2017	2016
Cash	$24,318,000	$22,176,000	$23,913,000	$21,935,000
Receivables from broker-dealers and clearing organizations	3,243,000	2,858,000	3,047,000	3,108,000
Securities owned (excludes warrants)	3,592,000	1,206,000	2,515,000	1,782,000
Accrued commissions and payroll payable, accounts payable and accrued expenses	19,489,000	15,404,000	19,135,000	17,255,000

We maintain a relatively high level of liquidity on our balance sheet. At both December 31, 2017 and 2016 respectively, 48% and 46% of our total assets consisted of cash, securities owned and receivables from clearing brokers and other broker-dealers. The level of cash used in each asset class is subject to fluctuation based on market volatility, revenue production and trading activity in the marketplace.

National Securities is subject to the Securities and Exchange Commission Uniform Net Capital Rule (Rule 15c3-1) (the Rule), which, among other things, requires the maintenance of minimum net capital. At December 31, 2017, National Securities had net capital of $9,954,024 which was $9,704,024 in excess of its required net capital of $250,000. National Securities is exempt from the provisions of the SEC's Rule 15c3-3 since it is an introducing broker-dealer that clears all transactions on a fully disclosed basis and promptly transmits all customer funds and securities to clearing brokers.

vFinance Investments is also subject to the Rule, which, among other things, requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2017, vFinance Investments had net capital of $1,153,017 which was $153,017 in excess of its required net capital of $1,000,000. vFinance Investments percentage of aggregate indebtedness to net capital was 2.5 to 1. vFinance Investments is exempt from the provisions of the SEC's Rule 15c3-3 since it is an introducing broker-dealer that clears all transactions on a fully disclosed basis and promptly transmits all customer funds and securities to clearing brokers.

Advances, dividend payments and other equity withdrawals from its Broker-Dealer Subsidiaries are restricted by the regulations of the SEC, and other regulatory agencies. These regulatory restrictions may limit the amounts that a subsidiary may dividend or advance to the Company.

During the first three months of fiscal 2018 and 2017, the Broker-Dealer Subsidiaries were in compliance with the rules governing dividend payments and other equity withdrawals.

The Company extends unsecured credit in the normal course of business to its brokers. The determination of the appropriate amount of the reserve for uncollectible accounts is based upon a review of the amount of credit extended, the length of time each receivable has been outstanding, and the specific individual brokers from whom the receivables are due.

We do not have any material commitments for capital expenditures. We routinely purchase computer equipment and technology to maintain or enhance the productivity of our employees and such capital expenditures amounted to $45,000 and $164,000 during the first three months of fiscal 2018 and 2017, respectively.

Cash Flows for the Three Months Ended December 31, 2017 and 2016

	Three months ended December 31,	
	2017	2016
Cash flows from operating activities		
Net (loss) income	$(8,040,000)	$5,059,000
Non-cash adjustments		
Change in fair value of warrant liability	5,597,000	(4,092,000)
Depreciation and amortization	379,000	295,000
Stock based compensation	258,000	—
Deferred tax expense	2,318,000	268,000
Other	131,000	41,000
Changes in assets and liabilities		
Receivables from clearing organizations, broker-dealers and others	(195,000)	2,159,000
Accounts payable and accrued expenses and other liabilities	2,062,000	(3,999,000)
Prepaid expenses	(423,000)	56,000
Other	(1,142,000)	855,000
Net cash provided by operating activities	945,000	642,000
Cash flows from investing and financing activities		
Acquisition of businesses	(124,000)	(19,000)
Purchase of fixed assets	(36,000)	(141,000)
Collection on notes receivable	25,000	—
Repurchase of shares of common stock	—	—
Net cash used in investing and financing activities	(135,000)	(160,000)
Net increase in cash	$810,000	$482,000

Net cash provided by operating activities increased $303,000 for the three months ended December 31, 2017, compared to the three months ended December 31, 2016. The increase in net cash provided by operating activities was primarily due to higher operating revenues collected for the three months ended December 31, 2017.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a material current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk

Our primary market risk arises from the fact that we engage in proprietary trading and make dealer markets in equity securities. Accordingly, we may be required to maintain certain amounts of inventories in order to facilitate customer order flow. We may incur losses as a result of price movements in these inventories due to changes in interest rates, foreign exchange rates, equity prices and other political factors. We are not subject to direct market risk due to changes in foreign exchange rates. However, we are subject to market risk as a result of changes in interest rates and equity prices, which are affected by global economic conditions. We manage our exposure to market risk by limiting our net long or short positions. Trading and inventory accounts are monitored daily by management and we have instituted position limits.

Credit risk represents the amount of accounting loss we could incur if counterparties to our proprietary transactions fail to perform and the value of any collateral proves inadequate. Although credit risk relating to various financing activities is reduced by the industry practice of obtaining and maintaining collateral, we maintain more stringent requirements to further reduce our exposure. We monitor our exposure to counterparty risk on a daily basis by using credit exposure information and monitoring collateral values. We maintain a credit committee, which reviews margin requirements for large or concentrated accounts and sets higher requirements or requires a reduction of either the level of margin debt or investment in high-risk securities or, in some cases, requiring the transfer of the account to another broker-dealer.

We monitor our market and credit risks daily through internal control procedures designed to identify and evaluate the various risks to which we are exposed. There can be no assurance, however, that our risk management procedures and internal controls will prevent losses from occurring as a result of such risks.

The following table shows the fair values of our securities owned as of December 31, 2017:

	Securities owned
Corporate stocks	$65,000
Municipal bonds	3,452,000
Restricted stock	75,000
Warrants	4,518,000
Total	$8,110,000

Operational Risk

Operational risk generally refers to the risk of loss resulting from our operations, including, but not limited to, improper or unauthorized execution and processing of transactions, deficiencies in our technology or financial operating systems and inadequacies or breaches in our control processes. We operate in a dynamic market and are reliant on the ability of our employees and systems to process a large number of transactions. These risks are less direct and quantifiable than credit and market risk, but managing them is critical, particularly in a rapidly changing environment with increasing transaction volumes. In the event of a breakdown or improper operation of systems or improper action by employees, we could suffer financial loss, regulatory sanctions and damage to our reputation. Business continuity plans exist for critical systems, and redundancies are built into the systems as deemed appropriate. In order to mitigate and control operational risk, we have developed and continue to enhance specific policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout our organization and within various departments. These control mechanisms attempt to ensure that operational policies and procedures are being followed and that our employees operate within established corporate policies and limits.

Risk Management

We have established various committees of the Board of Directors to manage the risks associated with our business. Our Audit Committee was established for the primary purpose of overseeing (i) the integrity of our unaudited and audited condensed consolidated financial statements, (ii) our compliance with legal and regulatory requirements that may impact our unaudited condensed consolidated financial statements or financial operations, (iii) the independent auditor's qualifications and independence and (iv) the performance of our independent auditor and internal audit function.

In addition, we have written policies and procedures that govern the conduct of business by our employees and our relationship with our clients. Our client policies address the extension of credit for client accounts, data and physical security, compliance with industry regulation and codes of ethics to govern employee conduct among other matters.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

Disclosure controls and procedures are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), are recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosure.

Based on our evaluation of disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) required by the Exchange Act Rules 13a-15(b) or 15d-15(b), our Principal Executive Officer and Principal Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were adequate and effective to ensure that material information relating to us and our consolidated subsidiaries would be made known to them by others within those entities, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in internal controls.

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We and our subsidiaries are defendants or respondents in various pending and threatened arbitrations, administrative proceedings and lawsuits seeking compensatory damages. Several cases have no stated alleged damages. Claim amounts are infrequently indicative of the actual amounts we will be liable for, if any. Further, we have a history of collecting amounts awarded in these types of matters from our registered representatives that are still affiliated, as well as from those that are no longer affiliated. Many of these claimants also seek, in addition to compensatory damages, punitive or treble damages, and all seek interest, costs and fees. These matters arise in the normal course of business. We intend to vigorously defend our company in these actions, and the ultimate outcome of these matters cannot be determined at this time.

Liabilities for potential losses from complaints, legal actions, government investigations and proceedings are established where management believes that it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. In making these decisions, management bases its judgments on its knowledge of the situations, consultations with legal counsel and its historical experience in resolving similar matters. In many lawsuits, arbitrations and regulatory proceedings, it is not possible to determine whether a liability has been incurred or to estimate the amount of that liability until the matter is close to resolution. However, accruals are reviewed regularly and are adjusted to reflect management’s estimates of the impact of developments, rulings, advice of counsel and any other information pertinent to a particular matter. Because of the inherent difficulty in predicting the ultimate outcome of legal and regulatory actions, management cannot predict with certainty the eventual loss or range of loss related to such matters. As of December 31, 2017 and September 30, 2017, the Company accrued approximately $1,789,000 and $2,403,000, respectively. These amounts are included in accounts payable and other accrued expenses in the statements of financial condition. Awards ultimately paid, if any, may be covered by our errors and omissions insurance policy. While we will vigorously defend our company in these matters, and will assert insurance coverage and indemnification to the maximum extent possible, there can be no assurance that such matters will not have a material adverse impact on our financial position, results of operations or cash flows.

ITEM 1A. RISK FACTORS

There are no material changes from the risk factors previously disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

In August 2015, the Board of Directors authorized the repurchase of up to $2 million of our common stock. Share repurchases, if any, could be made using a variety of methods, which may include open market purchases, privately negotiated transactions or block trades, or any combination of such methods, in accordance with applicable insider trading and other securities laws and regulations. The Board of Directors did not stipulate an expiration date for this repurchase and the purchase decisions are at the discretion of our management. There were no share repurchases during the three months ended December 31, 2017.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

31.1	Principal Executive Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Principal Financial Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Principal Executive Officer's Certificate pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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101.INS**	XBRL Instance
101.SCH**	XBRL Taxonomy Extension Schema
101.CAL**	XBRL Taxonomy Extension Calculation
101.DEF**	XBRL Taxonomy Extension Definition
101.LAB**	XBRL Taxonomy Extension Labels
101.PRE**	XBRL Taxonomy Extension Presentation
** XBRL	information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

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

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES

February 14, 2018	By:	/s/ Michael Mullen
		Michael Mullen
		Chief Executive Officer
		(Principal Executive Officer)
February 14, 2018	By:	/s/ Glenn C. Worman
		Glenn C. Worman
		Chief Financial Officer
		(Principal Financial Officer)

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