

Capital Financial Holdings, Inc  
Form 10-Q  
May 10, 2010

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

**FORM 10-Q**

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-25958

**CAPITAL FINANCIAL HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

North Dakota

45-0404061

(State or other jurisdiction

(I.R.S. Employer

of incorporation or organization)

Identification No.)

1 Main Street North  
Minot, North Dakota 58703

(Address of principal executive offices) (Zip code)

(701) 837-9600

(Registrant's telephone number, including area code)

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

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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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes

No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

As of April 30, 2010, there were 14,455,943 common shares of the issuer outstanding.

**FORM 10-Q**

**CAPITAL FINANCIAL HOLDINGS, INC.**

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**FINANCIAL INFORMATION**

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**PART I—FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

**CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS**

**ASSETS**

(Unaudited)

March 31,

December 31,

2010

2009

**CURRENT ASSETS**

Cash and cash equivalents

\$

1,997,552

\$

1,968,738

Accounts receivable (net of an allowance of  
\$24,000 for 2010 and 2009)

1,357,415

1,242,630

Income taxes receivable

179,425

173,502

Deferred tax asset—current

23,521

45,032

Current portion of long-term receivable

254,247

254,247

Prepays

37,036

27,849

Total current assets

\$

3,849,196

\$

3,711,998

**LONG-TERM ASSETS**

LT receivable—MF Division Sale

\$

762,740

762,740

Less: current portion shown above

(254,247)

(254,247)

Total long-term assets

\$

508,493

508,493

**PROPERTY AND EQUIPMENT**

\$

1,718,403

\$

1,711,245

Less accumulated depreciation

(553,953)

(536,395)

Net property and equipment

\$

1,164,450

\$

1,174,850

**OTHER ASSETS**

Goodwill

\$

3,405,151

\$

3,431,641

Deferred tax asset—non-current

462,776

474,755

Other assets (net of accumulated amortization

208,277

198,991

of \$213,405 for 2010 and \$209,422 for 2009)

Total other assets

\$

4,076,204

\$

4,105,387

**TOTAL ASSETS**

\$

9,598,343

\$

9,500,728

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS



**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

(Unaudited)

March 31,

December 31,

2010

2009

**CURRENT LIABILITIES**

Accounts payable

\$

92,949

\$

103,726

Commissions payable

1,395,280

1,115,134

Other current liabilities

58,113

54,765

Current portion of long-term debt

279,039

278,117

Total current liabilities

\$

1,825,381

\$

1,551,742

**LONG-TERM LIABILITIES**

Note payable

\$

300,541

\$

307,902

Convertible promissory note

950,000

950,000

Other long-term liabilities

430,602

475,157

Less current portion of long-term debt

(279,039)

(278,117)

Total long-term liabilities

\$

1,402,104

\$

1,454,942

**TOTAL LIABILITIES**

\$

3,227,485

\$

3,006,684

**STOCKHOLDERS' EQUITY**

Series A preferred stock—5,000,000 shares authorized, \$.0001 par value;

\$

305

\$

305

3,050,000 and 3,050,000 shares issued and outstanding, respectively

Additional paid in capital—series A preferred stock

1,524,695

1,524,695

Common stock—1,000,000,000 shares authorized, \$.0001 par value;

1,446

1,446

14,455,943 and 14,455,943 shares issued and outstanding, respectively

Additional paid in capital—common stock

10,396,334

10,396,335

Accumulated deficit

(5,551,922)

(5,428,737)

**TOTAL STOCKHOLDERS' EQUITY**

\$

6,370,858

\$

6,494,044

**TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY**

\$

9,598,343

\$

9,500,728

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS



**CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

Three Months Ended

March 31,

2010

2009

**OPERATING REVENUES**

Fee income

\$

245,365

\$

257,776

Commissions

4,157,845

3,972,479

Other income

132,353

121,418

Total revenue

\$

4,535,563

\$

4,351,673

**OPERATING EXPENSES**

Compensation and benefits

\$

336,724

\$

424,620

Commission expense

3,923,233

3,817,562

General and administrative expenses

289,213

269,068

Depreciation and amortization

21,541

29,064

Total operating expenses

\$

4,570,711

\$

4,540,314

**OPERATING LOSS**

\$

(35,148)

\$

(188,641)

**OTHER EXPENSES**

Interest expense

\$

(20,391)

\$

(67,688)

**LOSS OF CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE**

\$

(55,539)

\$

(256,329)

**INCOME TAX BENEFIT (EXPENSE)**

(44,772)

100,481

**NET LOSS BEFORE DISCONTINUED OPERATIONS**

\$

(100,311)

\$

(155,848)

**DISCONTINUED OPERATIONS**

Income from operation of discontinued mutual fund segment (net of tax)

\$

-

\$

8,707

**NET LOSS**

\$

(100,311)

\$

(147,141)

**NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

\$

(.01)

\$

(.01)

Diluted

\$

(.01)



\$

(.01)

**SHARES USED IN COMPUTING NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

14,638,937

14,528,087

Diluted

14,638,937

14,528,087

**NET LOSS PER COMMON SHARE:**

Basic

(.01)

(.01)

Diluted

(.01)

(.01)

**SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:**

Basic

14,638,937

14,528,087

Diluted

14,638,937

14,528,087

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

Three Months Ended

March 31,

2010

2009

**CASH FLOWS FROM OPERATING ACTIVITIES**

Net loss

\$

(100,311)

\$

(147,141)

Adjustments to reconcile net loss to net cash provided (used) by operating activities:

Depreciation and amortization

21,541

29,064

Loss on sale of assets

-

8,044

(Increase) decrease in:

Accounts receivable

(114,785)

154,900

Income taxes receivable

(5,923)

(68,952)

Prepays

(9,187)

12,346

Deferred tax asset

33,490

14,210

Other assets

(13,269)

(36,390)

Increase (decrease) in:

Service fees payable

-

1,088

Accounts payable

(10,777)

(202,134)

Commissions payable

280,146

8,495

Other liabilities

3,348

(140,753)

Net cash provided (used) by operating activities

\$



84,273

\$

(367,223)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Purchase of property and equipment

\$

(7,158)

\$

(3,821)

Net cash used by investing activities

\$

(7,158)

\$

(3,821)

**CASH FLOWS FROM FINANCING ACTIVITIES**

Issuance of common stock

\$

-

\$

(860)

Reduction of notes payable

(7,361)

(6,315)

Reduction of long-term liability

(18,065)

(23,700)

Repayments from ESOP

-

1,673

Preferred dividends paid

(22,875)

(22,875)

Net cash used by financing activities

\$

(48,301)

\$

(52,077)

**NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**

\$

28,814

\$

(423,121)

**CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR**

\$

1,968,738

2,840,108

**CASH AND CASH EQUIVALENTS AT END OF PERIOD**

\$

1,997,552

\$

2,416,987

**SUPPLEMENTAL SCHEDULE OF NONCASH**

**INVESTING AND FINANCING ACTIVITIES:**

Decrease in goodwill

\$

26,490

\$

23,550

Decrease in other long-term liabilities

26,490

23,550

Preferred stock dividends declared

22,875

22,875

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**CAPITAL FINANCIAL HOLDINGS., AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**  
**March 31, 2010 and 2009**

**NOTE 1—BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements of Capital Financial Holdings, Inc., a North Dakota corporation, and its subsidiary (collectively, the "Company"), included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the footnotes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2009, of Capital Financial Holdings, Inc., as filed with the SEC. The condensed consolidated balance sheet at December 31, 2009, contained herein, was derived from audited financial statements, but does not include all disclosures included in the Form 10-K and applicable under accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America, but not required for interim reporting purposes, have been condensed or omitted.

In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (which are of a normal, recurring nature) necessary for a fair presentation of the financial statements. The results of operations for the three months ended March 31, 2010, are not necessarily indicative of operating results for the entire year.

**NOTE 2—RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS**

A summary of our significant accounting policies is included in Note 1 on pages F-10 through F-11 of our 2009 Form 10-K.

The Company adopted Accounting Standards Codification ("ASC") 805, Business Combinations. ASC 805 generally requires an acquirer to recognize the identifiable assets acquired, liabilities assumed, contingent purchase consideration and any noncontrolling interest in the acquiree at fair value on the date of acquisition. It also requires an acquirer to recognize as expense most transaction and restructuring costs as incurred, rather than include such items in the cost of the acquired entity. For the Company, ASC 805 applies prospectively to business combinations for which the acquisition date is on or after October 1, 2009. The adoption of ASC 805 did not have a material impact on the Company's condensed consolidated financial statements.

The Company adopted ASC 820-10, Fair Value Measurements and Disclosures, for nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of ASC 820-10 did not have a material impact on the Company's condensed consolidated financial statements.

In December of 2007, the FASB established new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, these new standards require the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated net income on the face of the income statement.

These new standards are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of these new standards has not had a significant effect on the Company's consolidated financial statements.



### **NOTE 3—RECLASSIFICATION**

Certain amounts in the 2009 condensed consolidated financial statements have been reclassified to conform to the 2010 presentation. These reclassifications had no effect on the Company's net income (loss).

### **NOTE 4—INCOME TAXES**

The Company has completed various acquisitions in prior years, which have been classified as goodwill at the time of acquisition. The Company amortizes certain goodwill for tax purposes. The Company tests goodwill for impairment annually for book purposes, during the second quarter of each fiscal year. The annual test is done at the reporting unit level using a fair value approach, in accordance with the FASB accounting and reporting standards. Deferred tax assets or deferred tax liabilities may result from these timing differences.

The Company has adopted the FASB accounting and reporting standards for share-based payment (See Note 8—Stock Warrants, Stock Splits, and Stock Options.) As a result, the Company expenses stock-based employee compensation for book purposes on the grant date, but does not expense them for tax purposes until such options are exercised. Deferred tax assets are a result of these timing differences.

The Company has state and federal operating loss carryforwards that will expire over the next six to twenty years if unused. Deferred tax assets are a result of these timing differences.

### **NOTE 5—BUSINESS ACQUISITIONS**

On April 22, 2005, the Company acquired the management rights to the IPS Millennium Fund and the IPS New Frontier Fund from IPS Advisory, Inc. ("IPS Advisory"), and merged them into a new Integrity Fund called the Integrity Growth & Income Fund. The two funds had combined assets of approximately \$57 million at the time of acquisition. The purchase agreement called for total consideration of approximately 656,000 common shares of the Company. The Company provided IPS Advisory with 250,000 common shares upon closing. The remaining consideration of approximately 406,000 common shares, which was subject to adjustment based on retention of assets in the fund, was to be issued as follows: 203,000 common shares at the one-year anniversary of the closing date, and 203,000 common shares at the two-year anniversary of the closing date. The shares are subject to a put option, which allows the holders of the shares to put them back to the Company at a price equal to the market price of the Company's shares as of the closing date, which was \$.36 per share. The put option is exercisable with respect to one-third of the shares per year starting on the third anniversary of the closing date. The Company will also provide IPS Advisory with a stock option incentive bonus based on growth in assets in the Fund based on the following schedule: 150,000 options on the Company's common shares if assets of the Fund reach \$100 million and 150,000 options on the Company's common shares if the assets of the Fund reach \$200 million. The options will have a strike price of \$.65 per share and mature 10 years from the closing date. The securities issued in connection with this transaction were issued on a private placement basis. In April of 2006, the one-year anniversary payment of 158,603 common shares was made, which reflected the assets of the acquired funds at the one-year anniversary. In June of 2007, the two-year anniversary payment of 138,797 common shares was made, which reflected the assets of the acquired funds at the two-year anniversary. The liability relating to this acquisition is valued at \$49,967 as of March 31, 2010 and has been recorded by the Company as goodwill.

On March 7, 2007, the Company acquired certain assets of United Heritage Financial Services, Inc. (UHFS), a wholly owned subsidiary of United Heritage Financial Group, Inc., of Meridian, Idaho. UHFS had approximately 120 independent registered representatives who became part of Capital Financial Services, Inc. (CFS), the retail brokerage division of the Company. Pursuant to the agreement, in exchange for receipt of the assets of UHFS set forth above, the Company agreed to issue 500,000 restricted CFH shares and pay a deferred cash earn out payment totaling a maximum of \$900,000, to be paid in 21 quarterly installments. On March 7, 2007, the Company issued 500,000 restricted common shares to United Heritage Financial Group, Inc. As a result of this issuance of shares, \$175,000

was recorded by the Company as goodwill relating to the purchase of the assets. As of March 31, 2010, the Company had made eleven quarterly installment payments totaling \$271,936. The liability relating to this acquisition is valued at approximately \$380,635 as of March 31, 2010, and has also been recorded by the Company as goodwill. As of March 31, 2010, the total goodwill recorded relating to this acquisition was \$926,399.

**NOTE 6—DISCONTINUED OPERATIONS**

On March 6, 2009, Capital Financial Holdings, Inc. (the "Company") entered into a Definitive Agreement (the "Agreement") with Corridor Investors, LLC ("Buyer"), pursuant to which Buyer agreed to purchase from Seller, and Seller agreed to sell to Buyer: (i) all of the issued and outstanding shares of each of three subsidiaries of the Company, Integrity Fund Services, Inc., a share transfer agency, Integrity Funds Distributor, Inc., a FINRA member broker dealer and Integrity Mutual Funds, Inc. of Nevada, a non-operating entity (the "Companies"); (ii) all of Seller's right, title and interest in and to certain tangible assets and (iii) the sale of certain assets of Integrity Money Management, Inc. related to its mutual fund advisory business. The purpose of the Agreement was to facilitate a change in advisor as well as to transfer, together with the operating subsidiaries, the combined mutual fund service business of the Seller currently provided to The Integrity Funds, Integrity Managed Portfolios, ND Tax-Free Fund, Inc., Montana Tax-Free Fund, Inc. and Integrity Fund of Funds, Inc. ("the Funds"), which are investment companies registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940. As of July 31, 2009, the required Fund shareholder approval from the various Funds had been received to consummate the change in advisor along with the transfer of the mutual fund service to the Buyer. As per the Agreement, at closing on July 31, 2009, the Buyer paid \$1,525,480 (60 BPS of the aggregate net assets, totaling \$254,246,596 as of July 30, 2009) to the Company and will pay three additional payments consisting of 10 BPS of the aggregate net assets as of July 30, 2010, 2011, and 2012 over the next three years. With the closing and transfer of entities, the Company is no longer involved in the mutual fund service business. The Company continues to operate as a Broker-Dealer through its wholly owned subsidiary Capital Financial Services, Inc. As a result of the transfer, post closing of the transaction, Integrity Fund Services, Inc., Integrity Funds Distributor, Inc. and Integrity Money Management, Inc., which constitutes the mutual fund division of the Company, will be reflected in the Company's future consolidated financial statements as a discontinued operation.

The results of the mutual fund segment are reported in the Company's Consolidated Statements of Operations separately as discontinued operations. In accordance with GAAP, the Consolidated Balance Sheets have not been restated.

Summarized financial information for discontinued operations is as follows:

Three Months ended  
March 31, 2010

Three Months ended  
March 31, 2009

Total revenues, net of interest expense

\$

-

\$

762,336

Gain from discontinued operations, net of tax

-

8,707

Gain on disposal of discontinued operations

-

-

Total gain on discontinued operations, net of tax

\$

-

\$

8,707

**NOTE 7—GOODWILL**

The changes in the carrying amount of goodwill for the three months ended March 31, 2010, are as follows:

Balance as of January 1, 2010

\$

3,431,641

Goodwill acquisition price adjustment during the period (see Note 5)

(26,490)

Balance as of March 31, 2010

\$

3,405,151

The Company tests goodwill for impairment annually during the second quarter of each fiscal year. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value, goodwill will be evaluated for impairment between annual tests.

#### **NOTE 8—STOCK WARRANTS, STOCK SPLITS, AND STOCK OPTIONS**

In December of 2005, the Company adopted the FASB accounting and reporting standards for share-based payment, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. There were no compensation costs or deferred tax benefits recognized for stock-based compensation awards for the three months ended March 31, 2010 and 2009.

Option activity for the twelve months ended December 31, 2009 and the three months ended March 31, 2010 was as follows:

Number of  
Options

Weighted Average Exercise Price per Share

Weighted Average Grant Date Fair Value

Aggregate  
Intrinsic Value

Outstanding on January 1, 2009

5,888,113

\$

.54

\$

.28

\$

1,081,950

Granted

-

-

-

Exercised

-

-

-

Canceled

-

-

-

Outstanding on December 31, 2009

5,888,113

\$

.54

\$

.28

\$

-

Granted

-

-

-

Exercised

-

-

-

Canceled

-

-

-

Outstanding on March 31, 2010

5,888,113

\$

.54

\$

.28

\$

-

Exercisable options totaled 5,888,113 at both December 31, 2009 and March 31, 2010.

**NOTE 9—DEBT**

Long-term debt at March 31, 2010 and December 31, 2009 was as follows:

Rate

Current Portion

2010

2009

First Western Bank

6.50%

30,562

300,541

307,902



Convertible promissory note

6.50%

-

950,000

950,000

IPS Acquisition

49,967

49,967

49,967

Future payments on acquisitions

198,510

380,635

425,190

Totals

	\$
	279,039
	\$
	1,681,143
	\$
	1,733,059

Summaries of the terms of the long-term debt agreements follow:

**First Western Bank**—In June of 1999, the Company converted its outstanding balance of \$500,000 borrowed on its bank line-of-credit to long-term debt. The debt was refinanced in September of 2009 and currently carries an interest rate of 6.50%, with monthly payments of \$4,105. On October 1, 2014, the remaining balance will be due in full.

**Subordinate Corporate Notes**—The Company approved a \$2 million intra-state subordinate corporate note offering limiting the sale in North Dakota, to North Dakota residents only. The subordinate corporate notes did not represent ownership in the Company. On June 23, 2009 and July 30, 2009 redemptions were processed, totaling \$200,000 and \$300,000 respectively. On September 30, 2009 the Company elected pursuant to the terms of its Corporate Note obligations to call and prepay its remaining \$1,500,000 Corporate Note obligation. This amount consists of all of outstanding Corporate Notes originally due January 1, 2011. By prepaying the Corporate Notes from available cash, the current asset position of the Company was reduced by \$1,591,613 and the Corporate Note liability of the same amount was eliminated. There was no prepayment charge or other cost to the Company associated with the prepayment.

**Convertible Promissory Note**—In October of 2006, the Company issued a \$950,000 convertible promissory note to PawnMart, Inc., in a private placement. The unsecured note carries an interest rate of 6.5% per annum, payable semi-annually, and matures on October 15, 2016. The holder of the note has the right, at any time after October 15, 2009, to convert the note in whole or in part, into \$0.0001 par value common shares of the Company. The conversion price shall be equal to \$0.50 per share. The entire principal amount of this note shall be automatically converted into common shares at the conversion price on October 15, 2016.

**Future Payments on Acquisitions**—see Note 5—Business Acquisitions

#### **NOTE 10—EARNINGS PER SHARE**

Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect per share amounts that would have resulted if dilutive potential common shares had been converted to common shares. The following reconciles amounts reported in the financial statements:

Three Months Ended March 31, 2010

Three Months Ended March 31, 2009

Numerator

Denominator

Per Share Amount

Numerator

Denominator

Per Share Amount

Income from continuing operations

\$

(100,311)

\$

(155,848)

Less: Preferred Stock Dividends

(22,875)

(22,875)

Loss Available to Common Shareholders—Basic Earnings per Share

\$

(123,186)

14,638,937

\$

(.01)

\$

(178,723)

14,528,087

\$

(.01)

Effect of Dilutive Securities:

Convertible Promissory Note Interest (net of taxes)

-

-

-

-

Preferred Stock Dividends

-

-

-

-

Stock Options and Warrants

-

-

-

-

Loss Available to Common Shareholders—Diluted Earnings per Share

\$

(123,186)

14,638,937

\$

(.01)

\$

(178,723)

14,528,087

\$

(.01)

Options and warrants to purchase 8,486,113 common shares at exercise prices between \$0.35 and \$1.43 were outstanding at March 31, 2009, but were not included in the computation of diluted earnings per share for the quarter ending March 31, 2010. The options and warrants were not included in the calculations because their exercise prices were greater than the average market price of the common shares during those periods.

The Company had outstanding, at March 31, 2010, 3,050,000 Series A preferred shares. The preferred shares are entitled to receive a cumulative dividend at a rate of 6% per year, payable quarterly. The preferred shares became convertible to the Company's common shares at the rate of one share of common shares for one share of Series A preferred shares at any time after September 30, 2009.

The Series A preferred shares were not included in the computation of diluted earnings per share for the quarter ended March 31, 2010, because their effect was anti-dilutive.

Additionally, the Company had outstanding at March 31, 2010, a \$950,000 convertible promissory note. The unsecured note carries an interest rate of 6.5% per year, payable semi-annually, and matures on October 15, 2016. The holder of the note has the right, at any time after October 15, 2009, to convert the note in whole or in part, into common shares of the Company at a conversion price of \$0.50 per share. The entire principal amount of this note shall be automatically converted into common shares at the conversion price on October 15, 2016.

The convertible promissory note was not included in the computation of diluted earnings per share for the quarter ended March 31, 2010 because the conversion price was greater than the average market price of the common shares during those periods.

#### **NOTE 11—FAIR VALUE DISCLOSURES**

FASB ASC 820 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, income or cost approach, as specified by FASB ASC 820, are used to measure fair value.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value in three broad levels:

- 

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities the Company has the ability to access.



- 

Level 2 inputs are inputs (other than quoted prices included within level 1) that are observable for the asset or liability, either directly or indirectly.

- 

Level 3 are unobservable inputs for the asset or liability and rely on management's own assumptions about the assumptions that market participants would use in pricing the asset or liability. (The unobservable inputs should be developed based on the best information available in the circumstances and may include the Company's own data.)

The application of valuation techniques applied to similar assets and liabilities has been consistently applied. The following is a description of the valuation methodologies used for instruments measured at fair value:

On February 12, 2009, CFS entered into a settlement agreement with a client, which resulted in CFS purchasing the client's investment in the Omega 2007 Drilling Program 1, LP. This limited partnership carries a "presentment" feature which will allow CFS to sell the investment to the General Managing Partner of the limited partnership; and this feature will become available three years from the date of the first income distribution, which was December of 2007. The fair market value of this \$76,876 investment is estimated to be \$45,000 based on discounted cash flows; however this amount could fluctuate with the prices of oil and natural gas. CFS will continue to carry the investment on its books at the \$45,000 value until the "presentment" feature can be utilized.

Carrying Value at March 31, 2010

Quarter ended  
March 31, 2010

Total

Level 1

Level 2

Level 3

Total Losses

Other Investment

\$

45,000

\$

-

\$

-

\$

45,000

\$

-

**NOTE 12—SUBSEQUENT EVENTS**

No significant events have occurred subsequent to the Company's quarter-end. Subsequent events have been evaluated through May 10, 2010, which is the date these financial statements were issued.

**Item 2.**

**Management's Discussion and Analysis of Financial Condition and Results of Operations**

**GENERAL**

Capital Financial Holdings, Inc. derives the majority of its revenues and net income from sales of mutual funds, insurance products, and various other securities through Capital Financial Services, Inc. ("CFS"), the Company's broker-dealer subsidiary.

The Company organizes its current business units into two reportable segments: broker-dealer services and oil and gas activities. The broker-dealer services segment distributes securities and insurance products to retail investors through a network of registered representatives. The oil and gas activities segment will seek opportunities in petroleum and natural gas exploration and production.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies.

Segment Information

Holding

Oil & Gas

Broker-Dealer

As of, and for the three months ended:

Company

Activities

Services

Total

**March 31, 2010**

Revenues from external customers

\$

35,726

\$

664

\$

4,499,173

\$

4,535,563

Inter-segment revenues

-

-

-

-

Interest expense

20,391

-

-

20,391

Depreciation and amortization

14,683

216

6,642

21,541

Income (loss) before income tax benefit (expense)

(163,155)

(1,400)

109,016

(55,539)

Income tax benefit (expense)

(2,418)

346

(42,700)

(44,772)

Net income (loss) before discontinued operations

(165,574)

(1,054)

66,316

(100,311)

Discontinued operations

-

-

-

-

Net income (loss) after discontinued operations

(165,573)

(1,054)

66,316

(100,311)

Segment assets

7,174,439

998,600

2,503,696

10,676,735

Expenditure for segment assets

-



-

7,158

7,158

Holding

Oil & Gas

Broker-Dealer

As of, and for the three months ended:

Company

Activities

Services

Total

**March 31, 2009**

Revenues from external customers

\$

(1,084)

\$

-

\$

4,356,881

\$

4,355,797

Inter-segment revenues

(4,124)

-

4,124

4,124

Interest Expense

67,688

-

-

67,688

Depreciation and amortization

22,966

-

6,098

29,064

Income (loss) before income tax benefit (expense)

(245,518)

-

(10,811)

(256,329)

Income tax benefit

15,943

-

4,200

20,143

Net loss before discontinued operations

(229,575)

-

(6,611)

(236,186)

Discontinued operations

-

-

-

89,045

Net loss after discontinued operations

(229,575)

-

(6,611)

(147,141)

Segment assets

8,742,329

-

3,312,423

12,054,752

Expenditure for segment assets

2,417

-

1,404

3,821

**Reconciliation of Segment Information**

For the Three Months Ended

March 31, 2010

March 31, 2009

Revenues:

Total revenues for reportable segments

\$

4,535,563

\$

4,355,797

Elimination of inter-company revenues

-

(4,124)

Consolidated total revenues

\$

4,535,563

\$

4,351,673

Profit:

Total reportable segment loss

\$

(100,311)

\$

(147,141)

Assets:



Total assets for reportable segments

\$

10,676,735

\$

12,054,752

Elimination of inter-company receivables

(1,078,392)

(78,392)

Consolidated assets

\$

9,598,343

\$

11,976,360

**RESULTS OF OPERATIONS**

Three Months Ended  
March 31,

2010

2009

Net loss

\$

(100,311)

(147,141)

Income per share:

Basic

\$

(.01)

\$

(.01)

Diluted

\$

(.01)

\$

(.01)

The Company reported a net loss for the quarter ended March 31, 2010, of \$100,311, compared to net loss of \$147,141 for the same quarter in 2009.

### **Operating revenues**

Total operating revenues for the quarter ended March 31, 2010 were \$4,535,563, an increase of 4% from \$4,351,673 for the quarter ended March 31, 2009. The increase resulted primarily from an increase in commissions received by CFS, the Company's broker-dealer division.

### ***Fee Income***

Fee income for the quarter ended March 31, 2010 was \$245,365, a decrease of 5% from \$257,776 for the quarter ended March 31, 2009. The decrease was due primarily to a reduction in fees received by CFS, due to a reduction in assets under management in CFS' registered investment advisor.

The Company earns investment advisory fees in connection with CFS' registered investment advisor. The Company pays the registered representatives a portion of this fee income as commission expense and retains the balance. These fees constituted 5% of the Company's consolidated revenues in 2010.

### ***Commission Income***

Commission income includes CFS. The Company pays the registered representatives a percentage of this income as commission expense and retains the balance. Commission income for the quarter ended March 31, 2010 was \$4,157,845, a 5% increase from \$3,972,479 in 2009. The increase was due primarily to an increase in commissions received by CFS due to market conditions. Future market conditions will continue to impact commission levels. Commission revenues constituted 92% of the Company's consolidated revenues in 2010.

### ***Other income***

Other income for the quarter ended March 31, 2010 was \$132,353, an increase of 9% from \$121,418 for the quarter ended March 31, 2009. The increase was due primarily to an increase in rental income received by the Holding Company. Other income constituted 3% of the Company's consolidated revenues for the three months ended March 31, 2010.

### ***Operating expenses***

Total operating expenses for the quarter ended March 31, 2010 were \$4,570,711, an increase of 1% from \$4,540,314 for the quarter ended March 31, 2009. The increase resulted from the net increase in the expense categories described in the paragraphs below.

### ***Compensation and benefits***

Compensation and benefits expense for the quarter ended March 31, 2010 was \$336,724, a decrease of 21% from \$424,620 for the quarter ended March 31, 2009. The decrease resulted primarily from a reduction in incentive overrides paid to certain employees for the recruitment of new registered representatives in CFS, as well as a reduction in the number of employees over the past twelve months.

### ***Commission expense***

Commission expense for the quarter ended March 31, 2010 was \$3,923,233 an increase of 3% from \$3,817,562 for the quarter ended March 31, 2009. The increase in commission expense corresponds with the increase in commission

income.

### ***General and administrative expense***

Total general and administrative expenses for the quarter ended March 31, 2010 were \$289,213, an increase of 7% from \$269,068 for the quarter ended March 31, 2009. The increase was due to sub-advisory expenses CFH was required to pay in regards to the IPS Acquisition (See Note 5). As a result of this acquisition, until April 22, 2010, CFH was obligated to pay 30 bps of the Integrity Growth and Income Fund's Assets Under Management, as of the last day of each month. These, along with additional sub-advisory expenses, were previously paid by Integrity Money Management, until the sale of the Mutual Fund Division was finalized.

### ***Depreciation and amortization***

Depreciation and amortization expense for the quarter ended March 31, 2010 was \$21,541, a decrease of 26% from \$29,064 for the quarter ended March 31, 2009. The decrease for the three month period was due to the disposal of assets associated with the mutual fund division.

### ***Liquidity and capital resources***

Net cash provided by operating activities was \$84,275 for the three months ended March 31, 2010, as compared to net cash used by operating activities of \$367,223 during the three months ended March 31, 2009.

Net cash used by investing activities was \$7,158 for the three months ended March 31, 2010, compared to net cash used by investing activities of \$3,821 for the three months ended March 31, 2009. During the three months ended March 31, 2010, the primary use of cash for investing activities was the purchase of additional computer equipment and office furniture.

Net cash used by financing activities was \$48,302 for the three months ended March 31, 2010, compared to net cash used by financing activities of \$52,077 for the three months ended March 31, 2009. During the three months ended March 31, 2010, the Company paid out \$22,875 in preferred stock dividends, made a \$18,065 payment relating to the United Heritage acquisition (see Note 4—Business Acquisitions) and repaid \$7,361 of bank debt.

At March 31, 2010, the Company held \$1,997,552 in cash and cash equivalents, as compared to \$1,968,738 at December 31, 2009. The Company is required to maintain certain levels of cash and liquid securities in its broker-dealer subsidiaries to meet regulatory net capital requirements.

The Company has historically relied upon sales of its equity securities and debt instruments, as well as bank loans, for liquidity and growth. Management believes that the Company's existing liquid assets, along with cash flow from operations, will provide the Company with sufficient resources to meet its ordinary operating expenses during the next twelve months. Significant, unforeseen or extraordinary expenses may require the Company to seek alternative financing sources, including common or preferred share issuance or additional debt financing.

In addition to the liabilities coming due in the next twelve months, management expects that the principal needs for cash may be to acquire additional financial services firms, broker recruitment, asset acquisition opportunities for the Company's new oil and gas operations subsidiary, repurchase shares of the Company's common stock, and service debt. Management also expects to realize increases in expenses associated with regulatory compliance with Section 404 of the Sarbanes-Oxley Act of 2002, including increased legal, audit, staff, and consultant expenses as well as increased compliance and legal costs with respect to its broker dealer subsidiary related to regulatory and litigation matters.

## **FORWARD-LOOKING STATEMENTS**

When used herein, in future filings by the Company with the Securities and Exchange Commission ("SEC"), in the Company's press releases, and in other Company-authorized written or oral statements, the words and phrases "can be," "expects," "anticipates," "may affect," "may depend," "believes," "estimate," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Such statements are subject to certain risks and uncertainties, including those set forth in this "Forward-Looking Statements" section, which could cause actual results for future periods to differ materially from those presently anticipated or projected. The Company does not undertake and specifically disclaims any obligation to update any forward-looking statement to reflect events or circumstances after the date of such statements.

Until July 31, 2009 the Company derived substantially all of its revenues from two sources; commission revenue earned in connection with sales of shares of mutual funds, insurance products, and various other securities and fees relating to management of, and provision of services to mutual funds. Following the disposition of the Mutual Fund Services Segment, the Company has two operating subsidiaries, Capital Financial Services, Inc. ("CFS" or the "broker-dealer subsidiary") a FINRA member broker-dealer and Capital Energy Resources, Inc. ("CER" or the "oil and gas subsidiary").

The Company is a financial services holding company that, through its broker dealer subsidiary, provides brokerage, investment advisory, insurance and related services. The Company operates in a highly regulated and competitive industry that is influenced by numerous external factors such as economic conditions, marketplace liquidity and volatility, monetary policy, global and national political events, regulatory developments, competition, and investor preferences. The Company's revenues and net earnings may be either enhanced or diminished from period to period by such external factors. The Company remains focused on continuing to reduce redundant operating costs, upgrade operating efficiency, recruit quality representatives and grow our revenue base. The Company provides broker-dealer services in support of trading and investment by its representatives' customers in corporate equity and debt securities, U.S. Government securities, municipal securities, mutual funds, private placement alternative investments, variable annuities and variable life insurance. The Company also provides investment advisory services for its representatives' customers. In the past, investment advisory services were performed by both Capital Financial Services, Inc. on an individual client basis and Integrity Money Management, Inc. on behalf of the mutual fund segment; services through Integrity Money Management, Inc. have been discontinued as a result of the disposition of the Mutual Funds Service Segment effective July 31, 2009.

A key component of the broker-dealer subsidiaries' business strategy is to recruit well-established, productive representatives who generate substantial revenues from an array of investment products and services. Additionally, the broker-dealer subsidiary assists its representatives in developing and expanding their business by providing a variety of support services and a diversified range of investment products for their clients.

The Company is a financial services holding company that, through its broker-dealer subsidiary, provides brokerage, investment advisory, insurance and related services. The Company operates in a highly regulated and competitive industry that is influenced by numerous external factors such as economic conditions, marketplace liquidity and volatility, monetary policy, global and national political events, regulatory developments, competition, and investor preferences. Our revenues and net earnings may be either enhanced or diminished from period to period by such external factors. The Company remains focused on continuing to reduce redundant operating costs, upgrade operating efficiency, recruit quality representatives and grow our revenue base.

Forward-looking statements include, but are not limited to, statements about the Company's:

- 

Business strategies and investment policies,

- 

Possible or assumed future results of operations and operating cash flows,

- 

Financing plans and the availability of short-term borrowing,

- 

Competitive position,

- 

Potential growth opportunities,

- 

Recruitment and retention of the Company's key employees,

- 

Potential operating performance, achievements, productivity improvements, efficiency and cost reduction efforts,

- 

Likelihood of success and impact of litigation,

- 

Expected tax rates,

- 

Expectations with respect to the economy, securities markets, the market for merger and acquisition activity, the market for asset management activity, and other industry trends,

- 

Competition, and

- 

Effect from the impact of future legislation and regulation on the Company.

The following factors, among others, could cause actual results to differ materially from forward-looking statements, and future results could differ materially from historical performance:

- 

General political and economic conditions which may be less favorable than expected;



- The effect of changes in interest rates, inflation rates, the stock markets, or other financial markets;

- Unfavorable legislative, regulatory, or judicial developments;

- Adverse findings or rulings in arbitrations, litigation or regulatory proceedings;

- Incidence and severity of catastrophes, both natural and man-made;

- 

Changes in accounting rules, policies, practices, and procedures which may adversely affect the business;

- 

Terrorist activities or other hostilities which may adversely affect the general economy.

### **Item 3.**

#### **Quantitative and Qualitative Disclosures About Market Risk**

Not Applicable as a Smaller Reporting Company

### **Item 4.**

#### **Controls and Procedures**

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this report, pursuant to Rule 13a-15(b) of the Exchange Act. Based upon that evaluation, the Chief Executive & Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of March 31, 2010, and that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed and summarized, and reported within the time periods specified by the SEC's rules and forms.

There were no significant changes in the Company's internal controls over financial reporting during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **PART II—OTHER INFORMATION**

### **Item 1.**

#### **Legal Proceedings**

The Company operates in a legal and regulatory environment that exposes it to potentially significant litigation risks. As a result, the Company is involved in various disputes and legal proceedings, including litigation, arbitration and regulatory investigations, including a number of investigatory matters and legal proceedings arising out of customer allegations related to past commissioned sales of alternative investment products. In 2007 through the first quarter of 2009 a substantial amount (approximately 10% to 20%) of the Company's sales of commissioned products were in private placements of alternative products, two of which as of December 31, 2009 (Medical Capital Corporation and related issuer entities and Provident Royalties, LLC. and related issuer entities) were placed in receivership by action of the United States Securities and Exchange Commission and issuers of certain other alternative products sold by the Company are in Chapter 11 Bankruptcy or may have financial difficulties. Additionally, difficult economic conditions in general and the stock market decline have contributed to decline in broker-dealer subsidiary client portfolio values. As a result of such alleged failings of alternative products and the uncertainty of client recovery from the various product issuers, the Company is subject to regulatory scrutiny and a number of recently instituted legal or arbitration proceedings, including two recently instituted proceedings seeking certification as class actions which name the Company as one of a number of defendants and allege various securities or conduct violations, one with respect to private placements of Medical Capital Corporation and related issuer entities and the other with regard to private placements of Provident Royalties, LLC and related issuer entities. The Company intends to vigorously contest the allegations of the various proceedings and believes that there are multiple meritorious legal and fact based defenses in these matters. Such cases are subject to many uncertainties, and their outcome is often difficult to predict, including the impact on operations or on the financial statements, particularly in the earlier stages of a case. The Company makes provisions for cases brought against it when, in the opinion of management after seeking legal advice, it is probable that a liability exists, and the amount can be reasonably estimated. The current proceedings are subject to uncertainties and as such, the Company is unable to estimate the possible loss or a range of loss that may result.

### **Item 1A.**

#### **Risk Factors**

Not Applicable as a Smaller Reporting Company

### **Item 2.**

#### **Unregistered Sales of Equity Securities and Use of Proceeds**

*The Company has issued the following securities in the past quarter without registering the securities under the Securities Act:*

None

Small Business Issuer Repurchases of Equity Securities:

Period

Total Number of Shares Purchased

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Average Price Per Share

Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs

Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs

January 2010

-

-

-

\$597,754

February 2010

-

-

-

\$597,754

March 2010

-

-

-

\$597,754

Total

-

-

-

\$597,754

**Item 3.**

**Defaults Upon Senior Securities**

None

**Item 4.**

**Submission of Matters to a Vote of Security Holders**

None

**Item 5.**

**Other Information**

None

**Item 6.**

**Exhibits**

Exhibits

10.1

Employment Agreement—Bradley Wells\*

31.1

CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act

31.2

CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act

32.1

CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350

32.2

CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350

\* Indicates Management Contract or Compensatory Plan.

**CAPITAL FINANCIAL HOLDINGS, INC.**

**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.

Date: May 10, 2010

By /s/ Bradley P. Wells

Bradley P. Wells

Chief Executive Officer, Chief Financial Officer and President

(Principal Executive and Financial Officer)