

NATIONAL HOLDINGS CORP
Form 10-Q/A
October 25, 2006

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

FORM 10-Q/A

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

For the Quarter Ended March 31, 2006

Commission File Number 001-12629

NATIONAL HOLDINGS CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of organization)

36-4128138
(I.R.S. Employer incorporation or Identification
No.)

875 North Michigan Avenue, Suite 1560, Chicago, Illinois
(Address of principal executive offices)

60611
(Zip code)

Registrant's telephone number, including area code: (312) 751-8833

Olympic Cascade Financial Corporation
(Former name, if changed since last report)

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 checkmark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).
Yes No

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

The number of shares outstanding of registrant's common stock, par value \$0.02 per share, at October 23, 2006 was 5,223,968.

EXPLANATORY NOTE

This Quarterly Report on Form 10-Q/A (the “Report”) is being filed by National Holdings Corporation (the “Company”) to amend the Company's Quarterly Report on Form 10-Q for the period ended March 31, 2006 that was initially filed with the Securities and Exchange Commission (the “SEC”) on May 10, 2006. This Report reflects the restatement of the Company's Series B Preferred Stock outside of permanent equity on its balance sheet as of March 31, 2006.

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NATIONAL HOLDINGS CORPORATION AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

ASSETS

	March 31, 2006 (unaudited) (See: Note 2. Restatement)	September 30, 2005 (see note below)
CASH	\$ 2,236,000	\$ 398,000
DEPOSITS WITH CLEARING ORGANIZATIONS	300,000	300,000
RECEIVABLES FROM BROKER-DEALERS AND CLEARING ORGANIZATIONS	4,716,000	3,329,000
OTHER RECEIVABLES, net of allowance for uncollectible accounts of \$368,000 at March 31, 2006 and September 30, 2005, respectively	350,000	485,000
ADVANCES TO REGISTERED REPRESENTATIVES	1,599,000	1,653,000
SECURITIES HELD FOR RESALE, at market	466,000	166,000
FIXED ASSETS, net	299,000	250,000
SECURED DEMAND NOTE	1,000,000	1,000,000
OTHER ASSETS	501,000	379,000
TOTAL ASSETS	\$ 11,467,000	\$ 7,960,000

LIABILITIES AND STOCKHOLDERS' EQUITY

PAYABLE TO BROKER-DEALERS AND CLEARING ORGANIZATIONS	\$ 393,000	\$ 122,000
SECURITIES SOLD, BUT NOT YET PURCHASED, at market	73,000	44,000
ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES	5,474,000	4,045,000
CONVERTIBLE NOTES PAYABLE, net of debt discounts of \$178,000 and \$0 at March 31, 2006 and September 30, 2005, respectively	822,000	—
NOTES PAYABLE, net of debt discounts of \$85,000 and \$206,000 at March 31, 2006 and September 30, 2005, respectively	765,000	1,819,000
TOTAL LIABILITIES	7,527,000	6,030,000

SUBORDINATED BORROWINGS	1,000,000	1,000,000
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COMMITMENTS AND CONTINGENCIES

REDEEMABLE STOCK

Series B 10% cumulative convertible preferred stock, \$.01 par value, 20,000 shares authorized; 10,000 shares issued and outstanding (liquidation preference: \$1,000,000) at March 31, 2006 and 0 shares issued and outstanding at September 30, 2005

1,000,000

STOCKHOLDERS' EQUITY

Preferred stock, \$.01 par value, 200,000 shares authorized; 50,000 shares designated as Series A and 20,000 shares designated as Series B

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Series A 9% cumulative convertible preferred stock, \$.01 par value, 50,000 shares authorized; 35,316 shares issued and outstanding (liquidation preference: \$3,531,600) at March 31, 2006 and 33,320 shares issued and outstanding (liquidation preference: \$3,332,000) at September 30, 2005

Common stock, \$.02 par value, 30,000,000 shares authorized; 5,223,968 and 5,045,878 shares issued and outstanding, at March 31, 2006 and September 30, 2005, respectively	104,000	101,000
Additional paid-in capital	16,025,000	15,295,000
Deferred compensation	(83,000)	
Accumulated deficit	(14,106,000)	(14,466,000)
TOTAL STOCKHOLDERS' EQUITY	1,940,000	930,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 11,467,000	\$ 7,960,000

Note: The balance sheet at September 30, 2005 has been derived from the audited consolidated financial statements at that date.

See notes to condensed consolidated financial statements.

**NATIONAL
HOLDINGS
CORPORATION**

**CONDENSED
CONSOLIDATED
STATEMENTS
OF OPERATIONS
(Unaudited)**

	Three Months Ended		Six Months Ended	
	March 31, 2006	March 31, 2005	March 31, 2006	March 31, 2005
REVENUES:				
Commissions	\$ 10,714,000	\$ 8,850,000	\$ 17,871,000	\$ 19,146,000
Net dealer inventory gains	2,191,000	1,395,000	4,052,000	2,592,000
Investment banking	4,042,000	132,000	7,093,000	238,000
Interest and dividends	696,000	859,000	1,382,000	1,362,000
Transfer fees and clearing services	969,000	711,000	1,730,000	1,576,000
Other	175,000	259,000	347,000	401,000
TOTAL REVENUES	18,787,000	12,206,000	32,475,000	25,315,000
EXPENSES:				
Commissions	14,043,000	8,623,000	23,731,000	18,119,000
Employee compensation and related expenses	1,592,000	1,316,000	2,884,000	2,552,000
Clearing fees	436,000	323,000	800,000	670,000
Communications	546,000	370,000	1,033,000	835,000
Occupancy and equipment costs	633,000	757,000	1,308,000	1,473,000
Professional fees	246,000	305,000	584,000	719,000
Interest	176,000	109,000	285,000	228,000
Taxes, licenses, registration	169,000	48,000	314,000	159,000
Other administrative expenses	522,000	494,000	854,000	883,000
TOTAL EXPENSES	18,363,000	12,345,000	31,793,000	25,638,000
NET INCOME (LOSS)	424,000	(139,000)	682,000	(323,000)
Preferred stock dividends	(95,000)	(69,000)	(171,000)	(140,000)
Net income (loss) attributable to common stockholders	\$ 329,000	\$ (208,000)	\$ 511,000	\$ (463,000)
NET INCOME (LOSS) PER COMMON SHARE				
Basic:				
Net income (loss) attributable to common stockholders	\$ 0.06	\$ (0.04)	\$ 0.10	\$ (0.09)
Diluted:				

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Net income (loss) attributable to common stockholders	\$	0.04	\$	(0.04)	\$	0.07	\$	(0.09)
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Weighted average number of shares outstanding

Basic	5,089,625	5,013,434	5,068,451	5,003,291
Diluted	10,383,571	5,013,434	10,283,235	5,003,291

See notes to condensed consolidated financial statements.

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**NATIONAL
HOLDINGS
CORPORATION
AND
SUBSIDIARY**

**CONDENSED
CONSOLIDATED
STATEMENTS
OF CASH FLOWS
(Unaudited)**

	Six Months Ended	
	March 31, 2006	March 31, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	\$ 682,000	\$ (323,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Depreciation and amortization	68,000	85,000
Amortization of deferred financing costs	1,000	—
Amortization of note discount	130,000	91,000
Compensatory element of common stock issuance	12,000	—
Compensatory element of common stock option issuances	5,000	—
Issuance of common stock in settlement of arbitrations and claims	—	40,000
Changes in assets and liabilities		
Deposits with clearing organizations	—	495,000
Receivables from broker-dealers, clearing organizations and others	(1,198,000)	1,717,000
Securities held for resale, at market	(300,000)	(917,000)
Other assets	(96,000)	(80,000)
Payables	1,678,000	(1,640,000)
Securities sold, but not yet purchased, at market	29,000	707,000
Net cash provided by operating activities	1,011,000	175,000
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of fixed assets	(117,000)	(40,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net proceeds from issuance of common stock	175,000	—
Net proceeds from issuance of preferred stock	972,000	—
Net proceeds from issuance of convertible notes payable	1,000,000	—
Cash payment of deferred financing costs	(28,000)	—
Payment of notes payable	(1,175,000)	(75,000)
Exercise of stock options and warrants	—	20,000
Net cash (used in) provided by financing activities	944,000	(55,000)
NET INCREASE IN CASH	1,838,000	80,000
CASH BALANCE		
Beginning of the period	398,000	351,000
End of the period	\$ 2,236,000	\$ 431,000

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW
INFORMATION**

Cash paid during the period for:

Interest	\$	165,000	\$	147,000
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**SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING
AND
FINANCING ACTIVITIES**

Warrants issued in connection with debt	\$	187,000	\$	—
Preferred stock dividends	\$	300,000	\$	322,000

See notes to condensed consolidated financial statements.

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(UNAUDITED)

NOTE 1. BASIS OF PRESENTATION

The accompanying consolidated financial statements of National Holdings Corporation f/k/a Olympic Cascade Financial Corporation (“National Holdings” or the “Company”) have been prepared in accordance with generally accepted accounting principles 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 consolidated financial statements as of and for the periods ended March 31, 2006 and March 31, 2005 are unaudited. The results of operations for the interim periods are not necessarily indicative of the results of operations for the fiscal year. These consolidated financial statements should be read in conjunction with the consolidated financial statements and related footnotes included thereto in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2005.

NOTE 2. RESTATEMENT

In the Company’s Form 10-Q for the quarter ended March 31, 2006, the Company’s Series B Preferred Stock that was issued in a private placement in January 2006 was originally classified on the Company’s balance sheet as part of Stockholders’ Equity. This amended Report is being filed to classify the Company’s Series B Preferred Stock as Redeemable Preferred Stock on the Company’s balance sheet for the quarter ended March 31, 2006. This treatment is consistent with the treatment in the Company’s Form 10-Q for the quarter ended June 30, 2006, and is necessitated by certain redemption rights held by the New Investors at that time. Subsequent to June 30, 2006, the New Investors waived the provision which allowed for the contingent redemption, and the Series B Preferred Stock will be classified as part of Stockholders’ Equity in future filings.

NOTE 3. ACCOUNTING POLICY

In February 2006, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 155, which is an amendment of SFAS No. 133 and 140. This Statement (a) permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (b) clarifies which interest-only strip and principal-only strip are not subject to the requirements of SFAS 133, (c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (e) amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than

another derivative financial instrument. This Statement is effective for financial statements for fiscal years beginning after September 15, 2006. Earlier adoption of this Statement is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued any financial statements for that fiscal year. Management believes this Statement will not have an impact on the financial statements of the Company once adopted.

In March 2006, the FASB issued SFAS No. 156, which amends FASB Statement No. 140. This Statement establishes, among other things, the accounting for all separately recognized servicing assets and servicing liabilities. This Statement amends SFAS 140 to require that all separately recognized servicing assets and servicing liabilities be initially measured at fair value, if practicable. This Statement permits, but does not require, the subsequent measurement of separately recognized servicing assets and servicing liabilities at fair value. An entity that uses derivative instruments to mitigate the risks inherent in servicing assets and servicing liabilities is required to account for those derivative instruments at fair value. Under this Statement, an entity can elect subsequent fair value measurement to account for its separately recognized servicing assets and servicing liabilities. By electing that option, an entity may simplify its accounting because this Statement permits income statement recognition of the potential offsetting changes in fair value of those servicing assets and servicing liabilities and derivative instruments in the same accounting period. This Statement is effective for financial statements for fiscal years beginning after September 15, 2006. Earlier adoption of this Statement is permitted as of the beginning of an entity's fiscal year, provided the entity has not yet issued any financial statements for that fiscal year. Management believes this Statement will not have an impact on the financial statements of the Company once adopted.

NOTE 4. STOCK BASED COMPENSATION

Stock Based Compensation - Prior to October 1, 2005, the Company accounted for employee stock transactions in accordance with Accounting Principle Board, APB Opinion No. 25, "Accounting for Stock Issued to Employees." The Company had adopted the pro forma disclosure requirements of Statement of Financial Accounting Standards No. 123, "Accounting For Stock-Based Compensation."

Effective October 1, 2005, the Company adopted FASB Statement of Financial Accounting Standard ("SFAS") No. 123R "Share Based Payment". This statement is a revision of SFAS Statement No. 123, and supersedes APB Opinion No. 25, and its related implementation guidance. SFAS 123R addresses all forms of share based payment ("SBP") awards including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123R, SBP awards will result in a charge to operations that will be measured at fair value on the awards grant date, based on the estimated number of awards expected to vest over the service period. During the three and six months ended March 31, 2006, the Company granted 70,000 and 170,000 stock options, respectively, with a fair value of approximately \$55,000 and \$88,000, respectively. A charge of approximately \$4,000 was recorded in the three and six months ended March 31, 2006, relating to the amortization of the fair value associated with these grants.

For the three and six months ended March 31, 2005, the Company applied APB Opinion No. 25, "Accounting for Stock Issued to Employees." As required under SFAS No. 148, "Accounting for Stock-based Compensation - Transition and Disclosure," the following table presents pro forma net income and basic and diluted earnings per share as if the fair value-based method had been applied to all awards during that period.

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	Three months ended March 31, 2005	Six months ended March 31, 2005
Net income (loss) attributable to common stockholders - as reported	\$ (208,000)	\$ (463,000)
Stock-based employee compensation cost determined under fair value method, net of tax effects	(791,000)	(869,000)
Net income (loss) attributable to common stockholders - pro forma	\$ (999,000)	\$ (1,332,000)
Earnings (loss) per share		
Basic earnings (loss) per share:		
Net income (loss) attributable to common stockholders - as reported	\$ (0.04)	\$ (0.09)
Per share stock-based employee compensation cost determined under fair value method, net of tax effects	(0.16)	(0.17)
Net income (loss) attributable to common stockholders - pro forma	\$ (0.20)	\$ (0.26)
Diluted earnings (loss) per share:		
Net income (loss) attributable to common stockholders - as reported	\$ (0.04)	\$ (0.09)
Per share stock-based employee compensation cost determined under fair value method, net of tax effects	(0.16)	(0.17)
Net income (loss) attributable to common stockholders - pro forma	\$ (0.20)	\$ (0.26)

The Black-Scholes option valuation model is used to estimate the fair value of the options granted. The model includes subjective input assumptions that can materially affect the fair value estimates. The model was developed for use in estimating the fair value of traded options that have no vesting restrictions and that are fully transferable. For example, the expected volatility is estimated based on the most recent historical period of time equal to the weighted average life of the options granted. Options issued under the Company's option plans have characteristics that differ from traded options. In management's opinion, this valuation model does not necessarily provide a reliable single measure of the fair value of its employee stock options. Principal assumptions used in applying the Black-Scholes model along with the results from the model were as follows:

Assumptions:	2006	2005
Risk-free interest rate	4.40%	3.15%
Expected life, in years	3.0	5.0
Expected volatility	88%	135%

NOTE 5. SECURITIES HELD FOR RESALE AND SECURITIES SOLD, BUT NOT YET PURCHASED

The following table shows the quoted market values of the Company's securities held for resale and securities sold, but not yet purchased as of March 31, 2006:

Securities held for resale	Securities sold, but not yet purchased

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Corporate Stocks	\$	427,000	\$	73,000
Corporate Bonds		4,000		—
Government Obligations		35,000		—
	\$	466,000	\$	73,000

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NOTE 6. CLEARING AGREEMENTS

In April 2005, National Securities Corporation (“National Securities”) entered into a clearing agreement with National Financial Services LLC (“NFS”) that became effective in June 2005. The clearing agreement includes a termination fee if National Securities terminates the agreement without cause. Additionally, in June 2005, National Securities entered into a clearing agreement with Penson Financial Services, Inc. (“Penson”) for the purpose of providing clearing services that are not provided by NFS. The Company believes that the overall effect of these clearing relationships is beneficial to the Company’s cost structure, liquidity and capital resources.

NOTE 7. CONTINGENCIES

The NASD was engaged in an industry-wide investigation of mutual fund trading activities. National Securities is one of the numerous broker-dealers that were contacted by the NASD with respect to this investigation. The NASD identified certain customer mutual fund transactions ordered through National Securities during the time period from October 2000 to February 2003 that it believed constituted mutual fund timing and/or excessive trading activity. National Securities engaged in discussions and negotiations with the NASD to informally resolve these matters. Such resolution resulted in a settlement, whereby National Securities, without admitting or denying any violations, agreed to make both restitution and pay a fine to the NASD that in the aggregate approximated \$600,000. Additionally, the Company was obligated to pay the fines imposed by the NASD on two executive officers totaling \$50,000 pursuant to its indemnification obligations. The unpaid balance of approximately \$126,000 and \$219,000 at March 31, 2006 and 2005, respectively, has been included in “Accounts Payable, Accrued Expenses and Other Liabilities” in the accompanying consolidated statements of financial condition.

The Company is also a defendant in various other arbitrations and administrative proceedings, lawsuits and claims, seeking damages the Company approximates at \$700,000 (exclusive of unspecified punitive damages related to certain claims and inclusive of expected insurance coverage). The Company has filed a counterclaim for approximately \$220,000 in one such proceeding. These matters arise in the normal course of business. The Company intends to vigorously defend itself in these actions, and believes that the eventual outcome of these matters will not have a material adverse effect on the Company. However, the ultimate outcome of these matters cannot be determined at this time. The amounts related to such matters that are reasonably estimable and which have been accrued at March 31, 2006 and 2005, is \$228,000 and \$225,000 (including related legal fees), respectively, and have been included in “Accounts Payable, Accrued Expenses and Other Liabilities” in the accompanying consolidated statements of financial condition. The Company has included in “Professional fees” litigation and NASD related expenses of \$155,000 and \$212,000 for the second quarter of fiscal year 2006 and 2005, respectively, and \$400,000 and \$546,000 for the first six months of fiscal year 2006 and 2005, respectively.

NOTE 8. DIVIDENDS ON CONVERTIBLE PREFERRED STOCK

The holders of the Company’s Series A Convertible Preferred Stock, that are convertible into the Company’s common stock at \$1.25 per share, are to receive dividends on a quarterly basis at a rate of 9%

per annum per share. Such dividends are cumulative and are payable only when declared by the Company's Board of Directors. In March 2006, the Company's Board of Directors declared an in-kind dividend in the aggregate of 1,996 shares of Series A Preferred Stock, in payment of approximately \$300,000 of dividends accrued through March 31, 2006. Such shares were issued on April 30, 2006. At March 31, 2006, the accumulated dividend on the Company's 35,316 issued and outstanding shares of Series A Preferred Stock was \$0.

The holders of the Company's Series B Convertible Preferred Stock, that are convertible into the Company's common stock at \$.75 per share, are to receive dividends on a quarterly basis at a rate of 10% per annum per share. Such dividends are cumulative and are payable only when declared by the Company's Board of Directors. In March 2006, the Company's Board of Directors declared a cash dividend of \$21,000 payable to the holders of the Series B Preferred Stock that was paid in April 2006.

Both the holders of the Company's Series A and Series B Convertible Preferred Stock have voting rights equal to the number of common shares into which such preferred shares could be converted at a particular record date.

NOTE 9. INCOME (LOSS) PER COMMON SHARE

Basic income (loss) per share is computed on the basis of the weighted average number of common shares outstanding. Diluted income (loss) per share is computed on the basis of the weighted average number of common shares outstanding plus the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted.

The following table sets forth the components used in the computation of basic and diluted income (loss) per common share:

	Three Months Ended		Six Months Ended	
	March 31, 2006	March 31, 2005	March 31, 2006	March 31, 2005
Numerator:				
Net income (loss)	\$ 424,000	\$ (139,000)	\$ 682,000	\$ (323,000)
Preferred stock dividends	(95,000)	(69,000)	(171,000)	(140,000)
Numerator for basic earnings per share				
-- net income (loss) attributable to common stockholders - as reported	329,000	(208,000)	511,000	(463,000)
Effect of dilutive securities				
Interest on convertible notes	24,000	—	24,000	—
Preferred stock dividends	95,000	—	171,000	—
Numerator for basic earnings per share -- net income (loss) attributable to common stockholders - as adjusted	\$ 448,000	\$ (208,000)	\$ 706,000	\$ (463,000)
Denominator:				
Denominator for basic earnings per share--weighted average shares	5,089,625	5,013,434	5,068,451	5,003,291

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Effect of dilutive securities:

Stock options	37,372	—	17,905	—
Warrants	97,961	—	38,266	—
Assumed conversion of Series A Preferred Stock	2,825,280	—	2,825,280	—
Assumed conversion of Series B Preferred Stock	1,333,333	—	1,333,333	—
Assumed conversion of Note	1,000,000	—	1,000,000	—
Dilutive potential common shares	5,293,946	—	5,214,784	—
Denominator for diluted earnings per share--adjusted weighted-average shares and assumed conversions	10,383,571	5,013,434	10,283,235	5,003,291
Net income (loss) available to common stockholders				
Basic:	\$ 0.06	\$ (0.04)	\$ 0.10	\$ (0.09)
Diluted:	\$ 0.04	\$ (0.04)	\$ 0.07	\$ (0.09)

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For the three and six-month periods ended March 31, 2006, 2,904,784 and 3,304,784 shares, respectively, attributable to outstanding stock options and warrants, and for both the three and six-month periods ended March 31, 2005, 5,525,611 shares attributable to outstanding Series A Preferred Stock, stock options and warrants, were excluded from the calculation of diluted net income (loss) per share because if included the effect would be antidilutive.

NOTE 10. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES

Accounts payable, accrued expenses and other liabilities as of March 31, 2006 and September 30, 2005, respectively, consist of the following:

	March 31, 2006	September 30, 2005
Commissions payable	\$ 3,788,000	\$ 2,204,000
Legal payable	354,000	555,000
Other	1,332,000	1,286,000
Total	\$ 5,474,000	\$ 4,045,000

NOTE 11. NOTES PAYABLE

In January 2006, the Company used \$1.0 million of the proceeds from a private placement (See Note 11) to pay in full \$1.0 million of promissory notes held by two unrelated note holders that had a maturity date of July 31, 2007.

In February 2006, National Securities and the holder of a \$1.0 million secured demand note that was scheduled to mature on March 1, 2006, extended the term of the secured demand note to March 1, 2007.

NOTE 12. PRIVATE PLACEMENTS

In January 2006, the Company completed a financing transaction under which certain new investors (collectively, the “New Investors”) made a \$2.0 million investment in the Company (the “New Transaction”) by purchasing an aggregate of the following: (i) \$1.0 million of the Company’s newly created Series B Preferred Stock, which has a 10% dividend rate and is convertible into Common Stock at a price of \$.75 per share, and (ii) 11% convertible promissory notes in the principal amount of \$1.0 million, which are convertible into Common Stock at a price of \$1.00 per share with warrants to purchase an aggregate of 300,000 shares of Common Stock at an exercise price of \$1.00 per share.

The convertible promissory notes mature in January 2011, and have a stated interest rate of 11% per annum. The Company granted 300,000 warrants to acquire shares of common stock to the note holders, and the fair value of the warrants was calculated using the Black-Scholes Option Valuation Model. The Company recorded a debt discount of approximately \$187,000 that will be charged to interest expense over the life of the debt.

The investment by the New Investors included \$1.7 million by St. Cloud Capital Partners, L.P. (“St. Cloud”), and an aggregate of \$300,000 by two unrelated investors. Marshall S. Geller, the Senior Managing Member of SCGP, LLC, the General Partner of St. Cloud, became a member of the Board of Directors of the Company simultaneous with the closing of the New Transaction. The Company incurred legal fees and other costs related to this capital transaction, in the amount of \$56,000. The Company capitalized one-half of the fees to deferred financing costs that will be amortized to interest expense over the life of the convertible promissory notes and one-half of the fees were charged to paid-in capital.

The preferred stock and warrants were accounted for in accordance with EITF 98-5 and EITF 00-27. The preferred stock is considered permanent equity. The warrants and conversion option are components of equity and were not determined to be a derivative liability in accordance with SFAS No. 133 (par 11). The convertible promissory notes and warrants were accounted for in accordance with EITF 98-5 and EITF 00-27.

In March 2006, the Company issued 159,090 shares of the Company’s common stock to an unaffiliated party for \$175,000. The proceeds from the private placement were used to retire \$175,000 of the Company’s promissory notes that were due to mature in January 2007.

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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 Quarterly Report may contain certain statements of a forward-looking nature relating to future events or future business performance. Any such statements that refer to the Company's estimated or anticipated future results or other non-historical facts are forward-looking and reflect the Company's 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 in the Company's Annual Report on Form 10-K, filed with the Securities and Exchange Commission on December 28, 2004. Any forward-looking statements contained in or incorporated into this Quarterly Report speak only as of the date of this Quarterly Report. The Company undertakes no obligation to update publicly any forward-looking statement, whether as a result of new information, future events or otherwise.

RESULTS OF OPERATIONS

Three Months Ended March 31, 2006 Compared to Three Months Ended March 31, 2005

The Company's second quarter of fiscal year 2006 resulted in an increase in revenues, and a comparatively lesser increase in expenses compared to the same period last year. The increase in revenues is due to the stronger securities markets experienced by the Company, and the completion of investment banking transactions in the current year's quarter. As a result, the Company reported net income of \$424,000 compared with a net loss of \$139,000 for the second quarters of fiscal years 2006 and 2005, respectively. This represents an improvement of \$563,000 from the prior period.

	Three Months Ended		Increase (Decrease)	
	March 31,		Amount	Percent
	2006	2005		
Commissions	\$ 10,714,000	\$ 8,850,000	\$ 1,864,000	21%
Proprietary trading	2,062,000	1,372,000	690,000	50%
Market making	76,000	—	76,000	n/a
Mark-ups and mark-downs	53,000	23,000	30,000	130%
Net dealer inventory gains	2,191,000	1,395,000	796,000	57%
Investment banking	4,042,000	132,000	3,910,000	2962%
Interest and dividends	696,000	859,000	(163,000)	(19%)
Transfer fees and clearance services	969,000	711,000	258,000	36%
Other	175,000	259,000	(84,000)	(32%)
	\$ 18,787,000	\$ 12,206,000	\$ 6,581,000	54%

Total revenues increased \$6,581,000, or 54%, in the second quarter of fiscal year 2006 to \$18,787,000 from \$12,206,000 in the second quarter of fiscal year 2005. This increase is mainly due to the improved securities markets, and the completion of investment banking transactions. During the second quarter of fiscal year 2006, total trading volume increased 4%, compared to the second quarter of fiscal year 2005. The lesser increase in trading volume compared to revenues reflects an increase in the average revenue per trade, partially offset by the Company's re-entry into market making activities. Trading volume in this period related to retail brokerage increased 1%. Commission revenue increased \$1,864,000, or 21%, to \$10,714,000 from \$8,850,000 during the second quarter of fiscal year 2006 compared with the same period in fiscal year 2005. Net dealer inventory gains, which includes profits on proprietary trading, market making activities and customer mark-ups and mark-downs, increased \$796,000, or 57%, to \$2,191,000

from \$1,395,000 during the second quarter of fiscal year 2006 compared with the same period in fiscal year 2005.
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The increase is primarily due to an increase in proprietary trading in the bond market, and reflects the Company's re-entry into market making activities. During the second quarter of fiscal year 2006, revenues from proprietary trading increased \$690,000, or 50%, to \$2,062,000 from \$1,372,000 in the same period of fiscal year 2005, revenues from market making activities increased to \$76,000 from \$0 in the second quarter of fiscal year 2005, and revenues from customer mark-ups and mark-downs increased \$30,000, or 130%, to \$53,000 from \$23,000 in the second quarter of fiscal year 2005.

Investment banking revenue increased \$3,910,000, or 2,962%, to \$4,042,000 from \$132,000 in the second quarter of fiscal year 2006 compared with the second quarter of fiscal year 2005. The increase in investment banking revenues is attributable to the Company having completed investment banking transactions in the second quarter of fiscal year 2006. Interest and dividend income decreased \$163,000, or 19%, to \$696,000 from \$859,000 in the second quarter of fiscal year 2006 compared with the same period last year. The decrease in interest income is attributable to a decrease in the amount of debit balances in National Securities' customers accounts from the same period last year. Transfer fees increased \$258,000, or 36%, to \$969,000 in the second quarter of fiscal year 2006 from \$711,000 in the second quarter of fiscal year 2005. The increase reflects higher transfer fees for trades generated from the retail brokerage business of brokers recently associated with the Company.

Other revenue, consisting of asset management fees, and miscellaneous transaction fees and trading fees, decreased \$84,000, or 32%, to \$175,000 from \$259,000 during the second quarter of fiscal year 2006 compared to the second quarter of fiscal year 2005. The decrease is due to nonrecurring income realized in fiscal year 2005.

	Three Months Ended		Increase (Decrease)	
	2006	March 31, 2005	Amount	Percent
Commission expense related to:				
Commission revenue	\$ 9,449,000	\$ 7,638,000	\$ 1,811,000	24%
Net dealer inventory gains	1,644,000	879,000	765,000	87%
Investment banking	2,950,000	106,000	2,844,000	