NATIONAL HOLDINGS CORP
Form 10-Q
February 14, 2017

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, 2016	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.)

410 Park Ave, 14th Floor, New York, NY 10022
(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 or a smaller reporting company. See definition of "accelerated filer", "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (check one).

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 February 10, 2017 there were 12,437,916 shares of the registrant's common stock outstanding.

NATIONAL HOLDINGS CORPORATION
FORM 10-Q
QUARTERLY PERIOD ENDED DECEMBER 31, 2016

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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, 2016 (Unaudited)	September 30, 2016
ASSETS		
Cash	$22,176,000	$21,694,000
Restricted cash	354,000	354,000
Cash deposits with clearing organizations	1,030,000	1,030,000
Securities owned, at fair value	1,206,000	2,357,000
Receivables from broker-dealers and clearing organizations	2,858,000	3,357,000
Forgivable loans receivable	1,528,000	1,712,000
Other receivables, net	3,868,000	5,430,000
Prepaid expenses	1,854,000	1,910,000
Fixed assets, net	1,230,000	1,164,000
Intangible assets, net	5,718,000	5,704,000
Goodwill	6,531,000	6,531,000
Deferred tax asset, net	8,690,000	8,958,000
Other assets, principally refundable deposits	344,000	345,000
Total Assets	$57,387,000	$60,546,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Securities sold, but not yet purchased, at fair value	$1,000	$298,000
Accrued commissions and payroll payable	10,191,000	11,940,000
Accounts payable and accrued expenses	5,213,000	7,166,000
Deferred clearing and marketing credits	943,000	995,000
Warrants issuable	9,963,000	14,055,000
Other	244,000	319,000
Total Liabilities	26,555,000	34,773,000
Stockholders' Equity		
Preferred stock, $0.01 par value, 10,000,000 shares authorized; none outstanding	—	—
Common stock $0.02 par value, 150,000,000 shares authorized; 12,437,916 issued and outstanding at December 31, 2016 and September 30, 2016	248,000	248,000
Additional paid-in-capital	66,353,000	66,353,000
Accumulated deficit	(35,784,000)	(40,843,000)
Total National Holdings Corporation Stockholders' Equity	30,817,000	25,758,000
Non-Controlling interest	15,000	15,000
Total Stockholders' Equity	30,832,000	25,773,000
Total Liabilities and Stockholders' Equity	$57,387,000	$60,546,000

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,	
	2016	2015
Revenues		
Commissions	$24,506,000	$22,995,000
Net dealer inventory gains	2,511,000	2,544,000
Investment banking	9,726,000	6,117,000
Investment advisory	3,385,000	3,660,000
Interest and dividends	716,000	918,000
Transaction fees and clearing services	2,498,000	2,372,000
Tax preparation and accounting	856,000	900,000
Other	371,000	116,000
Total Revenues	44,569,000	39,622,000
Operating Expenses		
Commissions, compensation and fees	37,258,000	34,710,000
Clearing fees	738,000	763,000
Communications	722,000	829,000
Occupancy	1,008,000	935,000
License and registration	405,000	355,000
Professional fees	1,263,000	1,086,000
Interest	4,000	1,000
Depreciation and amortization	295,000	300,000
Other administrative expenses	1,230,000	1,287,000
Total Operating Expenses	42,923,000	40,266,000
Income (Loss) before Other Income and Income Taxes	1,646,000	(644,000)
Other Income		
Change in fair value of warrants issuable	4,092,000	—
Total Other Income	4,092,000	—
Income (Loss) before Income Taxes	5,738,000	(644,000)
Income tax expense (benefit)	679,000	(191,000)
Net Income (Loss)	$5,059,000	$(453,000)
Net income (loss) per share - Basic	$0.41	$(0.04)
Net income (loss) per share - Diluted	$0.41	$(0.04)
Weighted average number of shares outstanding - Basic	12,437,916	12,446,064
Weighted average number of shares outstanding - Diluted	12,438,474	12,446,064

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

NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited)
FOR THE THREE MONTHS ENDED DECEMBER 31, 2016

	Common Stock		Additional Paid-in-Capital	Accumulated Deficit	Non-Controlling Interest	Total Stockholder's Equity
	Shares	$				
Balance, September 30, 2016	12,437,916	$248,000	$66,353,000	$(40,843,000)	$ 15,000	$25,773,000
Net income				5,059,000		5,059,000
Balance, December 31, 2016	12,437,916	$248,000	$66,353,000	$(35,784,000)	$ 15,000	$30,832,000

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 STATEMENTS OF CASH FLOWS
(Unaudited)

	For The Three Month Period Ended December 31, 2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (loss)	$5,059,000	$(453,000)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities		
Change in fair value of warrants issuable	(4,092,000)	—
Depreciation and amortization	295,000	300,000
Amortization of forgivable loans to registered representatives	201,000	141,000
Stock-based compensation	—	37,000
Recovery for doubtful accounts	(115,000)	(31,000)
Amortization of deferred clearing credit	(52,000)	(53,000)
Increase in fair value of contingent consideration payable	7,000	4,000
Deferred tax (benefit) expense	268,000	(211,000)
Changes in assets and liabilities		
Restricted cash	—	—
Cash deposits with clearing organizations	—	—
Securities owned, at fair value	1,151,000	179,000
Receivables from broker-dealers and clearing organizations	499,000	336,000
Forgivable loans receivable	(17,000)	(136,000)
Other receivables, net	1,677,000	(791,000)
Prepaid expenses	56,000	(452,000)
Other assets, principally refundable deposits	1,000	11,000
Accounts payable, accrued expenses and other liabilities	(3,999,000)	(999,000)
Securities sold, but not yet purchased, at fair value	(297,000)	(27,000)
Net cash provided by (used in) operating activities	642,000	(2,145,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisition of business	(19,000)	—
Purchase of fixed assets	(141,000)	(151,000)
Net cash used in investing activities	(160,000)	(151,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repurchase of shares of common stock	—	(86,000)
Net cash used in financing activities	—	(86,000)
NET INCREASE (DECREASE) IN CASH	482,000	(2,382,000)
CASH BALANCE		
Beginning of the period	21,694,000	24,642,000
End of the period	$22,176,000	$22,260,000
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Interest	$4,000	$1,000

Income taxes	$81,000	$17,000
SUPPLEMENTAL DISCLOSURES OF NONCASH INVESTING AND FINANCING ACTIVITIES		
Fixed assets (acquired but not paid)	$23,000	$—
Business acquired:		
Identifiable intangible asset acquired	$211,000	$—
Contingent consideration payable	(192,000)	—
Cash paid	$19,000	$—

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

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NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2016
(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, 2016 and for the three months ended December 31, 2016 and 2015 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, 2016 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, 2016 for additional disclosures and accounting policies.

Certain items in the consolidated statement of operations for the fiscal 2016 period have been reclassified to conform to the presentation in the fiscal 2017 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, 2016 and September 30, 2016, the receivables of $2,858,000 and $3,357,000, 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, net, at December 31, 2016 and September 30, 2016 of $3,868,000 and $5,430,000, respectively, principally represent trailing fees and fees for tax and accounting services and are net of allowance for doubtful accounts of $620,000 and $735,000, respectively.

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 (interest rates ranging up to 9%). These notes have various schedules for repayment or forgiveness based on production or retention requirements being met and mature at various dates through 2021. Forgiveness of loans amounted to $201,000 and $141,000 for the three months ended December 31, 2016 and 2015, 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, 2016 and September 30, 2016, no allowance for doubtful accounts was required.

Forgivable loan activity for the three months ended December 31, 2016 is as follows:

Balance, October 1, 2016	$1,712,000
Additions	17,000
Amortization	(201,000)
Balance, December 31, 2016	$1,528,000

There were no unamortized loans outstanding at December 31, 2016 and September 30, 2016 attributable to registered representatives who ended their affiliation with the Broker-Dealer Subsidiaries prior to the fulfillment of their obligation.

NOTE 5. SECURITIES OWNED AND SECURITIES SOLD, BUT NOT YET PURCHASED AT FAIR VALUE

Classification of securities are as follows:

Fair Value Measurements

As of December 31, 2016

Securities owned at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	$172,000	—	—	$172,000
Municipal bonds	930,000	—	—	930,000

Restricted stock	—	104,000	—	104,000
	$1,102,000	$104,000	$ —	$1,206,000

Securities sold, but not yet purchased at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	$1,000	—	—	$1,000

As of September 30, 2016

Securities owned at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	$101,000	—	—	$101,000
Municipal bonds	2,111,000	—	—	2,111,000
Restricted stock	—	145,000	—	145,000
	$2,212,000	$145,000	$ —	$2,357,000

Securities sold, but not yet purchased at fair value	Level 1	Level 2	Level 3	Total
Corporate stocks	$298,000	$ —	$ —	$298,000

NOTE 6. FIXED ASSETS

Fixed assets as of December 31, 2016 and September 30, 2016 consist of the following:

	December 31, 2016	September 30, 2016	Estimated Useful Lives
Equipment	$1,155,000	$1,036,000	5
Furniture and fixtures	169,000	163,000	5
Leasehold improvements	692,000	653,000	Lesser of useful life or term of lease
Capital leases (primarily composed of computer equipment)	739,000	739,000	5
	2,755,000	2,591,000	
Less accumulated depreciation and amortization	(1,525,000)	(1,427,000)	
Fixed assets – net	$1,230,000	$1,164,000	

Depreciation expense associated with fixed assets for the three months ended December 31, 2016 and 2015 was $98,000 and $107,000, respectively.

NOTE 7. BUSINESS COMBINATION AND CONTINGENT CONSIDERATION

In October 2016, Gilman acquired certain assets of a tax preparation and accounting business that was deemed to be a business acquisition. The consideration for the transaction consisted of a cash payment at closing of $19,000 and contingent consideration payable in cash having a fair value of $192,000, for which a liability (included in Accounts payable and accrued expenses) was recognized based on the estimated acquisition date fair value of the potential earn-out. The earn-out is based on revenue, as defined in the acquisition agreement, during the 36-month period following the closing up to a maximum of $225,600. The liability was valued using an income-based approach using unobservable inputs (Level 3) and reflects the Company's own assumptions. The liability will be revalued at each Balance Sheet date with changes therein recorded in earnings. The fair value of the acquired assets was allocated to customer relationships, which is being amortized over three years. Results of operations of the acquired business are included in the accompanying consolidated statements of operations from the date of acquisition and were not material. In addition, based on materiality, pro forma results are not presented.

Set below are changes in the carrying value of contingent consideration for the three-month period ended December 31, 2016 related to acquisitions:

Fair value of contingent consideration at September 30, 2016	$424,000

Fair value of contingent consideration in connection with above acquisition	192,000
Payments	—
Change in fair value	7,000
Fair value of contingent consideration at December 31, 2016	$623,000

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NOTE 8. INTANGIBLE ASSETS

Intangibles consisted of the following at December 31, 2016 and September 30, 2016:

	December 31, 2016			
Intangible asset	Cost	Accumulated Amortization	Carrying Value	Estimated Useful Life (years)
Customer relationships	$7,180,000	$ 2,222,000	$4,958,000	3-10
Non-compete	296,000	296,000	—	2
Gilman brand name	760,000	—	760,000	Indefinite
	$8,236,000	$ 2,518,000	$5,718,000	

	September 30, 2016			
Intangible asset	Cost	Accumulated Amortization	Carrying Value	Estimated Useful Life (years)
Customer relationships	$6,969,000	$ 2,025,000	$4,944,000	7-10
Non-compete	296,000	296,000	—	2
Gilman brand name	760,000	—	760,000	Indefinite
	$8,025,000	$ 2,321,000	$5,704,000	

Amortization expense associated with intangible assets for the three months ended December 31, 2016 and 2015 was $197,000 and $193,000, 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, 2017	$595,000
2018	791,000
2019	791,000
2020	721,000
2021	721,000
Thereafter	1,339,000
Total	$4,958,000

NOTE 9. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses as of December 31, 2016 and September 30, 2016 consist of the following:

	December 31, 2016	September 30, 2016
Legal	$ 752,000	$ 1,346,000
Audit	263,000	198,000
Telecommunications	178,000	209,000
Data services	235,000	425,000
Regulatory	623,000	444,000
Settlements	421,000	832,000

Contingent consideration payable	623,000	424,000
Deferred rent	123,000	65,000
Other	1,995,000	3,223,000
Total	$ 5,213,000	$ 7,166,000

NOTE 10. PER SHARE DATA

Basic net income (loss) 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 income (loss) 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,	
	2016	2015
Basic weighted-average shares	12,437,916	12,446,064
Effect of dilutive securities:		
Options	558	—
Warrants	—	—
Diluted weighted-average shares	12,438,474	12,446,064

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

	Three Month Period Ended December 31,	
	2016	2015
Options	1,202,000	1,354,500
Warrants	21,558	—
	1,223,558	1,354,500

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 FASB issued an accounting standard update on revenue recognition. The new guidance 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.

In June 2014, the FASB issued ASU 2014-12, Compensation-Stock Compensation (Topic 718), which requires that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. The new guidance was effective for the Company beginning October 1, 2016. The adoption did not have any impact on the Company's financial statements.

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 is effective for the Company beginning October 1, 2017 for both interim and annual reporting periods. The Company is currently assessing the impact that the adoption of ASU 2016-09 will have on its financial statements.

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 is currently assessing the impact that the adoption of ASU 2016-18 will have on its financial statements.

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 January 2017, FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment", which eliminates the second step of the previous FASB guidance for testing goodwill for impairment and is intended to reduce cost and complexity of goodwill impairment testing. The standard is effective for the Company beginning October 1, 2020 for both interim and annual periods. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company is currently assessing the impact that the adoption of ASU 2017-04 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, 2016, 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, 2017	$2,230,000	$48,000	$2,182,000
2018	2,484,000	—	2,484,000
2019	1,814,000	—	1,814,000
2020	1,618,000	—	1,618,000
2021	1,308,000	—	1,308,000
Thereafter	2,322,000	—	2,322,000
	$11,776,000	$48,000	$11,728,000

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, 2016 and 2015 was $995,000 and $956,000, respectively. Sublease income under all operating subleases for the three months ended December 31, 2016 and 2015 was approximately $37,000 and $36,000, respectively.

As of December 31, 2016, the Company and its subsidiaries had three outstanding letters of credit, which have been issued in the maximum amount of $354,000 as security for property leases, and which are collateralized by the restricted cash as reflected in the 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, 2016 and September 30, 2016, the Company accrued approximately $421,000 and $832,000, respectively. These amounts are included in accounts payable and other liabilities in the statements of financial condition. The Company has included in "Professional fees" litigation and FINRA related expenses of

$546,000 and $225,000 for the three months ended December 31, 2016 and 2015, 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, 2016, National Securities had net capital of $8,562,434 which was $8,312,434 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, 2016, vFinance Investments had net capital of $2,319,352 which was $1,319,352 in excess of its required net capital of $1,000,000. vFinance Investments' ratio of aggregate indebtedness to net capital was 0.7 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. STOCK BASED COMPENSATION

Stock Options

Information with respect to stock option activity during the three months ended December 31, 2016 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, 2016	1,221,500	$ 6.51	$ 1.22	3.31	$ —
Forfeited	(7,500)	$ 3.80	$ 1.66		$ —
Outstanding at December 31, 2016	1,214,000	$ 6.53	$ 1.22	3.06	$ —
Vested and exercisable at December 31, 2016	1,214,000	$ 6.53	$ 1.22	3.06	$ —

As of September 30, 2016, all compensation expense associated with the grants of stock options had been recognized. During the three months ended December 31, 2015, the Company recognized compensation expense of $37,000 related to stock options.

Warrants

The following table summarizes information about warrant activity during the three months ended December 31, 2016 (not including the warrants discussed in Note 18):

	Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual

		Per Share	Term
Outstanding at September 30, 2016	23,029	$ 5.00	0.75
Forfeited or expired	(1,471)	$ 5.00	
Outstanding and exercisable at December 31, 2016	21,558	$ 5.00	0.54

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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, 2016, the Company did not repurchase any shares. During the three months ended December 31, 2015, the Company repurchased 33,933 common shares at a cost of approximately $86,000.

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 tax expense (benefit) for the three month periods ended December 31, 2016 and 2015 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 periods ended December 31, 2016 and 2015 differs from the federal statutory income tax rate principally due to non-deductible expenses and state and local income taxes and with respect to the 2017 period non-taxable income related to the change in fair value of warrants issuable.

At December 31, 2016, 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, 2016 and 2015 is as follows:

	Brokerage and Advisory Services	Tax and Accounting Services	Corporate		Total
Three Months Ended December 31, 2016					
Revenues	$43,713,000	$856,000	$ —		$44,569,000
Pre-tax income (loss)	3,096,000	(712,000)	3,354,000	(a)	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
2015					
Revenues	$38,722,000	$900,000	$ —		$39,622,000

Pre-tax income (loss)	1,023,000	(1,158,000)	(509,000)	(c)	(644,000)
Assets	40,716,000	2,929,000	18,160,000	(b)	61,805,000
Depreciation and amortization	199,000	45,000	56,000		300,000
Interest	1,000	—	—		1,000
Capital expenditures	106,000	18,000	27,000		151,000

(a) Consists of fair value gain of warrants issuable offset by operating expenses not allocated to reportable segments.
(b) Consists principally of deferred tax asset.
(c) Consists of operating expenses not allocated to reportable segments.

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NOTE 19. ACQUISITION OF CONTROLLING INTEREST IN THE COMPANY

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 (such time of acceptance, the "Acceptance Time") 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 will receive 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 December 31, 2016 or 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, the fair value of the 12,437,916 warrants issuable are being classified as a liability in the condensed consolidated statement of financial condition at December 31, 2016 and September 30, 2016. 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 warrants issuable” in the condensed consolidated statements of operations. Such valuation (using level 2 inputs) was determined by use of the Black-Scholes option pricing model using the following assumptions:

	Fiscal Year 2017	Fiscal Year 2016
Dividend yield	0.00 %	0.00 %
Expected volatility	38.24 %	38.20 %
Risk-free interest rate	1.93 %	1.14 %
Life (in years)	5	5

In the Merger Agreement, the Company agreed to set a record date within ninety (90) days following the Acceptance Time with respect to the distribution to its stockholders of warrants to purchase one share of its common stock for every share of its common stock owned at an exercise price of $3.25 per share (the “Dividend Warrants”). The Company announced on October 26, 2016, that it had established December 9, 2016 as the record date with respect to the Dividend Warrants.

As a result of “due bill” trading procedures, those persons who held shares of the Company's common stock as of the record date, or who acquire shares of the Company's common stock in the market following the record date, and in each case who continue to hold such shares at the close of trading the date before the ex-dividend date to be established by The Nasdaq Stock Market with respect to the Dividend Warrants, will be entitled to receive a Dividend Warrant with respect to each share of the Company's common stock owned by such person as of the ex-dividend date.

Conversely, those persons who held shares of the Company's common stock as of the record date, or who acquire shares of the Company's common stock in the market following the record date, but in each case who do not hold such shares of the Company's common stock at the close of trading on the date before the ex-dividend date, will not be entitled to receive any Dividend Warrants with respect to such shares.

Therefore, a shareholder selling their shares of the Company's common stock prior to the ex-dividend date would not receive any Dividend Warrants with respect to the shares that are sold by such person even if such person held the shares on the record date, since the shares of the Company's common stock sold would be accompanied by a “due-bill” entitling the buyer of those shares to receive the Dividend Warrants with respect to such shares.

The actual right to receive the Dividend Warrants with respect to any shares of the Company's common stock requires still holding such shares until the ex-dividend date.

The warrants and the shares of common stock issuable upon the exercise of the warrants, have been registered on a registration statement that was filed with the SEC and was declared effective January 13, 2017. The Company established January 18, 2017 as the distribution date of a dividend of warrants to purchase shares of the Company's common stock and the warrants began trading on the Nasdaq Capital Market under the symbol “NHLDW” on that date. NASDAQ Stock Market has established January 19, 2017 as the ex-dividend date for the dividend of the warrants.

NOTE 20. RELATED PARTY TRANSACTIONS

During the three months ended December 31, 2016 , Investment Banking revenues include approximately $2,665,000 of placement agent fees related to a private placement of shares and warrants for a subsidiary 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 is not required to consolidate such VIEs. Fees attributable to such arrangements for the three months ended December 31, 2016 and 2015 were $3.1 million and $2.7 million, respectively.

NOTE 22. SUBSEQUENT EVENTS

On January 26, 2017, the stockholders of the Company approved (i) to amend the Company's certificate of incorporation to decrease the number of authorized shares of its common stock from 150,000,000 shares to 75,000,000 shares and (ii) to amend the Company's 2013 Omnibus Incentive Plan to increase the number of shares of its common stock authorized for issuance by 650,000.

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, 2016. 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, 2016, we had approximately 1,190 associated personnel serving retail and institutional customers, trading and investment banking clients. In addition to our 34 Company offices located in New York, New Jersey, Florida, Texas, Washington and Illinois, we had approximately 127 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, 2016 Compared to Three Months Ended December 31, 2015

Summary

Our first quarter of fiscal year 2017 resulted in a 12% increase in revenues and a 7% increase in operating expenses. Contributing factors include increases in Commissions and Investment banking revenues due to a diversified product base in conjunction with favorable market conditions. Investment advisory, Interest and dividends, and Tax preparation and accounting revenues declined slightly and were offset by an increase in Transaction fees and Other revenues. The increase in operating expenses is directly related to the commission expense generated by the increase in revenues.

Favorable market conditions influenced an increase in transaction volumes for commissions. Our trading business remained constant when compared to prior year quarter. Investment advisory fees slipped during the quarter on a comparative basis due to the termination of an unprofitable client relationship late in December 2015.

Our investment banking business increased 59% over the prior year first quarter. The investment banking deal pipeline and execution had a significantly positive impact on variability in product offerings to our clients. Our tax and accounting revenues remained relatively unchanged when comparing to the prior year quarter.

Revenues

Total revenues increased $4,947,000, or 12%, to $44,569,000, in the current quarter as compared to $39,622,000 recorded in the comparative period last year.

	Three Months Ended December 31,		Increase (Decrease)	
	2016	2015	Amount	Percent
Commissions	$24,506,000	$22,995,000	$1,511,000	7 %
Net dealer inventory gains	2,511,000	2,544,000	(33,000)	(1)
Investment banking	9,726,000	6,117,000	3,609,000	59
Investment advisory	3,385,000	3,660,000	(275,000)	(8)
Interest and dividends	716,000	918,000	(202,000)	(22)
Transaction fees and clearing services	2,498,000	2,372,000	126,000	5
Tax preparation and accounting	856,000	900,000	(44,000)	(5)
Other	371,000	116,000	255,000	220
Total Revenues	$44,569,000	$39,622,000	$4,947,000	12 %

Commissions increased $1,511,000, or 7%, to $24,506,000 in the current quarter as compared to $22,995,000 recorded in the comparative period last year. Retail commissions increased this quarter primarily due to favorable markets and a diversified product base, which generated opportunities and liquidity events for our clients;

Net dealer inventory gains, decreased $33,000, or 1% to $2,511,000 in the current quarter as compared to $2,544,000 recorded in the comparative period last year. Revenues consisted primarily of market making, and customer trade facilitation, and include activities in equities, municipal and corporate debt and treasury bonds;

Investment banking fees increased $3,609,000, or 59%, to $9,726,000 in the current quarter as compared to $6,117,000 recorded in the comparative period last year. The expansion of industry coverage by our Investment banking team created a strong deal pipeline with solid offerings and execution, which has produced strong investments opportunities for our clients;

Investment advisory fees decreased $275,000, or 8%, to $3,385,000 in the current quarter as compared to $3,660,000 recorded in the comparative period last year. Average revenue earned on our asset portfolio has declined slightly due to a reduction of fees on certain asset classes, and the elimination of unprofitable business;

Interest and dividend income decreased $202,000, or 22%, to $716,000 in the current quarter as compared to $918,000 recorded in the comparative period last year. This decrease is primarily attributable to slightly lower customer margin and free cash balances in place during the quarter;

Transaction fees and clearing services increased $126,000, or 5%, to $2,498,000 in the current quarter as compared to $2,372,000 recorded in the comparative period last year. This increase is consistent with higher number of transactions made on behalf of our clients related to higher commission revenue;

Tax preparation and accounting fees decreased $44,000, or 5%, to $856,000 in the current quarter as compared to $900,000 recorded in the comparative period last year;

Other revenue increased $255,000, or 220%, to $371,000 in the current quarter as compared to $116,000 recorded in the comparative period last year. This increase is due to higher client participation on our fully paid lending program.

Operating Expenses

Total operating expenses increased $2,657,000, or 7%, to $42,923,000 in the current quarter as compared to $40,266,000 recorded in the comparative period last year. The increase in expenses is directly attributable to the increase in commissions, compensation and fees related to the higher revenues. Most other operating expense categories declined or immaterially increased as compared to the comparative period last year.

	Three Months Ended December 31,		Increase (Decrease)	
	2016	2015	Amount	Percent
Commissions, compensation and fees	$37,258,000	$34,710,000	$2,548,000	7 %
Clearing fees	738,000	763,000	(25,000)	(3)
Communications	722,000	829,000	(107,000)	(13)
Occupancy	1,008,000	935,000	73,000	8
License and registration	405,000	355,000	50,000	14
Professional fees	1,263,000	1,086,000	177,000	16
Interest	4,000	1,000	3,000	300
Depreciation and amortization	295,000	300,000	(5,000)	(2)
Other administrative expenses	1,230,000	1,287,000	(57,000)	(4)
Total Operating Expenses	$42,923,000	$40,266,000	$2,657,000	7 %

Commissions, compensation, and fees increased $2,548,000, or 7%, to $37,258,000 in the current quarter as compared to $34,710,000 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. This increase is attributable to the commission expense generated by the increase in Commissions and Investment banking revenue;

Clearing fees decreased $25,000, or 3%, to $738,000 in the current quarter as compared to $763,000 recorded in the comparative period last year;

Communications expenses decreased $107,000, or 13%, to $722,000 in the current quarter as compared to $829,000 recorded in the comparative period last year. This decrease is primarily due to expense control evaluation and renegotiation of various communication contracts;

Occupancy expenses increased $73,000, or 8%, to $1,008,000 in the current quarter as compared to $935,000 recorded in the comparative period last year;

License and registration expense increased by $50,000, or 14%, to $405,000 in the current quarter as compared to $355,000 recorded in the comparative period last year. This increase is attributable to the implementation of new supervisory software;

Professional fees increased by $177,000, or 16% to $1,263,000 in the current quarter as compared to $1,086,000 recorded in the comparative period last year. The increase is attributed to the general corporate matters in addition to the cost of defense associated with various arbitrations.

Interest expense increased by $3,000, to $4,000 in the current quarter as compared to $1,000 recorded in the comparative period last year;

Depreciation and amortization expenses decreased $5,000, or 2% to $295,000 in the current quarter as compared to $300,000 recorded in the comparative period last year;

Other administrative expenses decreased $57,000, or 4%, to $1,230,000 in the current quarter as compared to $1,287,000 recorded in the comparative period last year. This decrease is attributable to overall expense control focus.

NON-G.A.A.P. 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, 2016 and 2015, EBITDA, as adjusted, was $2,146,000 and $(165,000), respectively. This increase of $2,311,000, resulted primarily from higher profit margin generated by the increase of revenues in Investment banking transactions and operating expense controls.

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,	
	2016	2015
Net income (loss), as reported	$5,059,000	$(453,000)
Interest expense	4,000	1,000
Income taxes (benefit)	679,000	(191,000)
Depreciation	98,000	107,000
Amortization	197,000	193,000
EBITDA	6,037,000	(343,000)
Non-cash compensation expense	—	37,000
Change in fair value of warrants issuable	(4,092,000)	—
Forgivable loan amortization	201,000	141,000
EBITDA, as adjusted	$2,146,000	$(165,000)

EBITDA, adjusted for forgivable loan amortization and non-cash compensation expense, 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	
	2016	2015	2016	2015
Cash	$22,176,000	$22,260,000	$21,935,000	$23,451,000
Receivables from broker-dealers and clearing organizations	2,858,000	2,742,000	3,108,000	2,910,000
Securities owned	1,206,000	708,000	1,782,000	798,000
Accrued commissions and payroll payable, accounts payable and accrued expenses	15,404,000	15,842,000	17,255,000	16,344,000

We maintain a relatively high level of liquidity on our balance sheet. At both December 31, 2016 and 2015 respectively, 46% and 42% of our total assets consisted of cash, securities owned and receivables from clearing brokers and other broker-dealers and others. 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, 2016, National Securities had net capital of $8,562,434 which was $8,312,434 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, 2016, vFinance Investments had net capital of $2,319,352 which was $1,319,352 in excess of its required net capital of $1,000,000. vFinance Investments percentage of aggregate indebtedness to net capital was 0.7 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 2017 and 2016, 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 $164,000 and $151,000 during the first three months of fiscal 2017 and 2016, respectively.

	Three months ended December 31,	
	2016	2015
Cash flows from operating activities		
Net income (loss)	$5,059,000	$(453,000)
Non-cash adjustments		
Change in fair value of warrants issuable	(4,092,000)	—
Depreciation and amortization	295,000	300,000
Stock based compensation	—	37,000
Deferred tax expense (benefit)	268,000	(211,000)
Other	41,000	61,000
Changes in assets and liabilities		
Receivables from clearing organizations, broker-dealers and others	2,159,000	(591,000)
Accounts payable and accrued expenses and other liabilities	(3,999,000)	(999,000)
Prepaid expenses	56,000	(452,000)
Other	855,000	163,000
Net cash provided by (used in) operating activities	642,000	(2,145,000)
Cash flows from investing and financing activities		
Acquisition of business	(19,000)	—
Purchase of fixed assets	(141,000)	(151,000)
Repurchase of shares of common stock	—	(86,000)
Net cash used in investing and financing activities	(160,000)	(237,000)
Net increase (decrease) in cash	$482,000	$(2,382,000)

Three months ended December 31, 2016

The decrease in receivables from clearing organizations, broker-dealers and others at December 31, 2016 as compared to 2015, is a combination of lower commissions earned during the last month of the current quarter as compared to the same month of the previous year, as well as cash collections for Investment banking transactions. Commissions and Investment banking receivables are typically received within 10 days or 30 days of the close respectively.

The decrease in accounts payable, accrued expenses and other liabilities at December 31, 2016 as compared to 2015, is primarily due to timing differences in payments.

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 and securities sold, but not yet purchased as of December 31, 2016:

	Securities owned	Securities sold, but not yet purchased
Corporate stocks	$172,000	$ 1,000
Municipal bonds	930,000	—
Restricted stock	104,000	—
Total	$1,206,000	$ 1,000

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, 2016, 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, 2016 and September 30, 2016, the Company accrued approximately $421,000 and $832,000, 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, 2016.

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, 2016.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

10.1	Advisory Agreement between National Holdings Corporation and Caribe BioAdvisors, LLC, dated January 1, 2017.
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.

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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, 2017	By: /s/ Michael Mullen
	Michael Mullen
	Chief Executive Officer
	(Principal Executive Officer)
February 14, 2017	By: /s/ Glenn C. Worman
	Glenn C. Worman
	Chief Financial Officer
	(Principal Financial Officer)

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