

NATIONAL HOLDINGS CORP  
Form 10-Q  
February 09, 2007

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, 2006

Commission File Number 001-12629

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

Delaware  
(State or other jurisdiction of  
incorporation or organization)

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

120 Broadway, 27th Floor, New York, NY 10271  
(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 is a large accelerated filer, an accelerated filer or a non-accelerated filer (see definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (check one)).  
Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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

As of February 7, 2007 there were 5,358,611 shares of the registrant's common stock outstanding.

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## NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

|   | December 31,<br>2006<br>(unaudited) | September 30,<br>2006<br>(see note below) |
|---|-------------------------------------|---|
| <b>ASSETS</b>   |                                     |   |
| CASH  | \$ 243,000                          | \$ 1,441,000                              |
| DEPOSITS WITH CLEARING ORGANIZATIONS  | 301,000                             | 300,000                                   |
| RECEIVABLES FROM BROKER-DEALERS AND CLEARING ORGANIZATIONS  | 5,434,000                           | 3,548,000                                 |
| OTHER RECEIVABLES, net of allowance for uncollectible accounts of \$467,000 at December 31, 2006 and September 30, 2006, respectively | 464,000                             | 380,000                                   |
| ADVANCES TO REGISTERED REPRESENTATIVES  | 1,806,000                           | 1,556,000                                 |
| SECURITIES OWNED  |                                     |   |
| Marketable, at market value   | 1,937,000                           | 475,000                                   |
| Non-marketable, at fair value   | 32,000                              | 402,000                                   |
| FIXED ASSETS, net   | 270,000                             | 305,000                                   |
| SECURED DEMAND NOTE   | 1,000,000                           | 1,000,000                                 |
| OTHER ASSETS  | 438,000                             | 300,000                                   |
| <b>TOTAL ASSETS</b>   | <b>\$ 11,925,000</b>                | <b>\$ 9,707,000</b>                       |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

|   |                  |                  |
|---|------------------|------------------|
| PAYABLE TO BROKER-DEALERS AND CLEARING ORGANIZATIONS  | \$ 1,662,000     | \$ 113,000       |
| SECURITIES SOLD, BUT NOT YET PURCHASED, at market   | 275,000          | 162,000          |
| ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES  | 4,441,000        | 3,943,000        |
| CONVERTIBLE NOTES PAYABLE, net of debt discounts of \$150,000 and \$159,000 at December 31, 2006 and September 30, 2006, respectively | 850,000          | 841,000          |
| NOTES PAYABLE, net of debt discounts of \$25,000 and \$45,000 at December 31, 2006 and September 30, 2006, respectively               | 825,000          | 805,000          |
| <b>TOTAL LIABILITIES</b>  | <b>8,053,000</b> | <b>5,864,000</b> |

|                         |           |           |
|-------------------------|-----------|-----------|
| SUBORDINATED BORROWINGS | 1,000,000 | 1,000,000 |
|-------------------------|-----------|-----------|

## COMMITMENTS AND CONTINGENCIES

## 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 Series A 9% cumulative convertible preferred stock, \$.01 par value, 50,000

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shares authorized; 35,316 shares issued and outstanding (liquidation preference: \$3,531,600) at December 31, 2006 and September 30, 2006

|   |                      |                     |
|---|----------------------|---------------------|
|   | -                    | -                   |
| Series B 9% cumulative convertible preferred stock, \$.01 par value, 20,000 shares authorized; 10,000 shares issued and outstanding (liquidation preference: \$1,000,000) at December 31, 2006 and September 30, 2006 | -                    | -                   |
| Common stock, \$.02 par value, 30,000,000 shares authorized; 5,358,611 and 5,223,968 shares issued and outstanding, at December 31, 2006 and September 30, 2006, respectively   | 107,000              | 104,000             |
| Additional paid-in capital  | 17,092,000           | 16,956,000          |
| Accumulated deficit   | (14,327,000)         | (14,217,000)        |
| <b>TOTAL STOCKHOLDERS' EQUITY</b>   | <b>2,872,000</b>     | <b>2,843,000</b>    |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>   | <b>\$ 11,925,000</b> | <b>\$ 9,707,000</b> |

Note: The balance sheet at September 30, 2006 has been derived from the audited consolidated financial statements at that date.

See notes to condensed consolidated financial statements.

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

|   | Three Months Ended   |                      |
|---|----------------------|----------------------|
|   | December 31,<br>2006 | December 31,<br>2005 |
| <b>REVENUES:</b>                                      |                      |                      |
| Commissions   | \$ 8,422,000         | \$ 7,157,000         |
| Net dealer inventory gains                            | 3,298,000            | 1,861,000            |
| Investment banking                                    | 556,000              | 3,052,000            |
| <b>Total commission and fee revenues</b>              | <b>12,276,000</b>    | <b>12,070,000</b>    |
| Interest and dividends                                | 566,000              | 686,000              |
| Transfer fees and clearing services                   | 1,010,000            | 762,000              |
| Other   | 434,000              | 173,000              |
| <b>TOTAL REVENUES</b>                                 | <b>14,286,000</b>    | <b>13,691,000</b>    |
| <b>EXPENSES:</b>                                      |                      |                      |
| Commissions ad fees                                   | 9,784,000            | 9,688,000            |
| Employee compensation and related expenses            | 1,514,000            | 1,292,000            |
| Clearing fees   | 375,000              | 364,000              |
| Communications  | 402,000              | 487,000              |
| Occupancy and equipment costs                         | 735,000              | 676,000              |
| Professional fees                                     | 958,000              | 338,000              |
| Interest  | 104,000              | 110,000              |
| Taxes, licenses, registration                         | 179,000              | 145,000              |
| Other administrative expenses                         | 320,000              | 332,000              |
| <b>TOTAL EXPENSES</b>                                 | <b>14,371,000</b>    | <b>13,432,000</b>    |
| <b>NET (LOSS) INCOME</b>                              | <b>(85,000)</b>      | <b>259,000</b>       |
| Preferred stock dividends                             | (105,000)            | (76,000)             |
| Net (loss) income attributable to common stockholders | \$ (190,000)         | \$ 183,000           |
| <b>NET (LOSS) INCOME PER COMMON SHARE</b>             |                      |                      |
| <b>Basic:</b>   |                      |                      |
| Net (loss) income attributable to common stockholders | \$ (0.04)            | \$ 0.04              |
| <b>Diluted:</b>                                       |                      |                      |
| Net (loss) income attributable to common stockholders | \$ (0.04)            | \$ 0.04              |
| <b>Weighted average number of shares outstanding</b>  |                      |                      |
| Basic   | 5,251,915            | 5,047,737            |

Diluted

5,251,915

7,294,903

See notes to condensed consolidated financial statements.

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

|   | Three Months Ended   |                      |
|---|----------------------|----------------------|
|   | December 31,<br>2006 | December 31,<br>2005 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                      |                      |
| Net (loss) income   | \$ (85,000)          | \$ 259,000           |
| Adjustments to reconcile net (loss) income to net cash provided by (used in) operating activities |                      |                      |
| Depreciation and amortization   | 37,000               | 32,000               |
| Amortization of deferred financing costs  | 1,000                | -                    |
| Amortization of note discount   | 29,000               | 33,000               |
| Compensatory element of common stock issuance   | -                    | 12,000               |
| Compensatory element of common stock options issuance   | 7,000                | -                    |
| Changes in assets and liabilities   |                      |                      |
| Deposits with clearing organizations  | (1,000)              | -                    |
| Receivables from broker-dealers, clearing organizations and others                                | (2,220,000)          | (132,000)            |
| Securities owned: marketable, at market value   | (1,462,000)          | (239,000)            |
| Securities owned: non-marketable, at fair value   | 370,000              | -                    |
| Other assets  | (138,000)            | 95,000               |
| Payables  | 2,046,000            | 129,000              |
| Securities sold, but not yet purchased, at market   | 113,000              | 40,000               |
| Net cash (used in) provided by operating activities   | (1,303,000)          | 229,000              |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>   |                      |                      |
| Purchase of fixed assets  | (2,000)              | (38,000)             |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>   |                      |                      |
| Dividends paid  | (25,000)             | -                    |
| Exercise of warrants  | 132,000              | -                    |
| Net cash provided by (used in) financing activities   | 107,000              | -                    |
| <b>NET DECREASE IN CASH</b>   | <b>(1,198,000)</b>   | <b>191,000</b>       |
| <b>CASH BALANCE</b>   |                      |                      |
| Beginning of the period   | 1,441,000            | 398,000              |
| End of the period   | \$ 243,000           | \$ 589,000           |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>  |                      |                      |
| Cash paid during the period for:  |                      |                      |
| Interest  | \$ 74,000            | \$ 77,000            |
| Series B preferred stock dividends  | \$ 25,000            | \$ -                 |

See notes to condensed consolidated financial statements.



**NATIONAL HOLDINGS CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2006  
(UNAUDITED)****NOTE 1. BASIS OF PRESENTATION**

The accompanying condensed consolidated financial statements of National Holdings 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 condensed consolidated financial statements as of December 31, 2006 and for the periods ended December 31, 2006 and December 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 condensed 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, 2006.

**NOTE 2. 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 months ended December 31, 2005, the Company granted 100,000 employee stock options with a fair value of \$33,000. No charge was recorded in the quarter ended December 31, 2005 as the expense incurred during the period associated with this grant was nominal. During the three months ended December 31, 2006, the Company granted 150,000 employee stock options with a fair value of \$96,400. No charge was recorded in the quarter ended December 31, 2006 as the expense incurred during the period associated with this grant was nominal.

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:

|                         | 2006  | 2005  |
|-------------------------|-------|-------|
| Assumptions:            |       |       |
| Risk-free interest rate | 4.40% | 4.40% |
| Expected life, in years | 3.0   | 3.0   |
| Expected volatility     | 122%  | 124%  |





A summary of the stock option activity as of December 31, 2006, and changes during the three month period then ended is presented below:

|                                   | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term | Aggregate<br>Intrinsic<br>Value |
|-----------------------------------|-----------|--|---|---------------------------------|
| Outstanding at September 30, 2006 | 932,000   | \$ 1.30                                  | 3.31  |                                 |
| Granted                           | 150,000   | \$ 1.30                                  | 4.99  |                                 |
| Expired                           | -         |  |   |                                 |
| Outstanding at December 31, 2006  | 1,082,000 | \$ 1.30                                  | 3.33  | \$ 252,000                      |
| Exerciseable at December 31, 2006 | 957,000   | \$ 1.32                                  | 3.16  | \$ 212,000                      |

As of December 31, 2006, there was \$158,000 of total deferred compensation costs related to share-based compensation arrangements.

A summary of the status of the Company's nonvested shares as of December 31, 2006, and changes during the three month period then ended is presented below:

| Nonvested Shares                | Shares   | Weighted<br>Average<br>Grant Date<br>Fair Value |
|---------------------------------|----------|---|
| Nonvested at September 30, 2006 | 75,000   | \$ 0.33   |
| Granted                         | 75,000   | \$ 0.78   |
| Vested                          | (25,000) | \$ 0.33   |
| Expired                         | -        |   |
| Nonvested at December 31, 2006  | 125,000  | \$ 0.60   |

### NOTE 3. SECURITIES OWNED AND SECURITIES SOLD, BUT NOT YET PURCHASED

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

|                        | Securities<br>owned | Securities sold, but<br>not yet purchased |
|------------------------|---------------------|---|
| Corporate stocks       | \$ 1,921,000        | \$ 230,000                                |
| Corporate bonds        | -                   | 45,000                                    |
| Government obligations | 16,000              | -   |
|                        | \$ 1,937,000        | \$ 275,000                                |



Non-marketable securities owned at December 31, 2006 consist of non-tradable warrants exercisable into freely trading common stock of public companies totaling \$32,000.

#### **NOTE 4. CLEARING AGREEMENTS**

In April 2005, the Company's wholly-owned subsidiary, National Securities Corporation ("National Securities") entered into a clearing agreement with National Financial Services LLC ("NFS") that became effective in June 2005. In the first quarter of fiscal year 2007, NFS paid National Securities a \$750,000 business credit that has been included in "Accounts Payable, Accrued Expenses and Other Liabilities" in the accompanying consolidated statements of financial condition as of December 31, 2006. 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 will be beneficial to the Company's cost structure, liquidity and capital resources.

#### **NOTE 5. CONTINGENCIES**

In September 2006, the former chairman and chief executive officer of the Company, Steven A. Rothstein, commenced an arbitration against the current chairman and chief executive officer of the Company, Mark Goldwasser, in the matter *Rothstein et al. vs. Goldwasser*, NASD No. 06-04000. Rothstein is alleging fraud and inequitable conduct relating to his attempts to sell his investment in the Company in calendar year 2001, and is seeking approximately \$5,750,000 in damages. The Company is indemnifying Mr. Goldwasser in this action. The Company and Mr. Goldwasser believe this action is without merit, and intend to vigorously defend this action.

The Company is a defendant in various other arbitrations and administrative proceedings, lawsuits and claims seeking in the aggregate damages of approximately \$1,600,000. The Company believes such claims are substantially without merit, and estimates that its liability, primarily for defense costs, will approximate \$160,000 (exclusive of unspecified punitive damages related to certain claims and inclusive of expected insurance coverage). 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 December 31, 2006 and 2005, is \$762,000 and \$245,000, respectively, and have been included in "Accounts Payable, Accrued Expenses and Other Liabilities" in the accompanying consolidated statements of financial condition. Approximately \$575,000 of the accrued legal fees at December 31, 2006 relates to the settlement of certain arbitrations. The Company has included in "Professional fees" litigation and NASD related expenses of \$789,000 and \$245,000 for the first quarter of fiscal year 2007 and 2006, respectively.

#### **NOTE 6. 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 entitled to receive dividends on a quarterly basis at a rate of 9% per annum, per share. Such dividends are cumulative and accrue whether or not declared by the Company's Board of Directors, but are payable only when, as and if declared by the Company's Board of Directors. At December 31, 2006, the amount of accumulated dividends on the Company's 35,316 issued and outstanding shares of Series A preferred stock was approximately \$239,000.

The holders of the Company's Series B Convertible preferred stock, convertible into the Company's common stock at \$.75 per share, are entitled 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 December 2006, the Company's Board of Directors declared a cash dividend of \$25,000 payable to the holders of the Series B

preferred stock that was paid in January 2007.

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**NOTE 7. INCOME PER COMMON SHARE**

Basic income per share is computed on the basis of the weighted average number of common shares outstanding. Diluted income 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 per common share:

|  | Three Months Ended   |                      |
|--|----------------------|----------------------|
|  | December 31,<br>2006 | December 31,<br>2005 |
| Numerator:   |                      |                      |
| Net income   | \$ (85,000)          | \$ 259,000           |
| Preferred stock dividends  | (105,000)            | (76,000)             |
| Numerator for basic earnings per share--net income attributable to common stockholders - as reported | (190,000)            | 183,000              |
| Effect of dilutive securities:   |                      |                      |
| Preferred stock dividends  | -                    | 76,000               |
| Numerator for basic earnings per share--net income attributable to common stockholders - as adjusted | \$ (190,000)         | \$ 259,000           |
| Denominator:   |                      |                      |
| Denominator for basic earnings per share--weighted average shares                                    | 5,251,915            | 5,047,737            |
| Effective of dilutive securities:  |                      |                      |
| Stock options  | -                    | 11,645               |
| Warrants   | -                    | 14,190               |
| Assumed conversion of:   |                      |                      |
| Series A Preferred Stock   | -                    | 2,221,331            |
| Series B Preferred Stock   | -                    | -                    |
| Notes  | -                    | -                    |
| Dilutive potential common shares   | -                    | 2,247,166            |
| Denominator for diluted earnings per share--adjusted weighted-average shares and assumed conversions | 5,251,915            | 7,294,903            |
| Net income available to common stockholders  |                      |                      |
| Basic:   | \$ (0.04)            | \$ 0.04              |
| Diluted:   | \$ (0.04)            | \$ 0.04              |

For the three-month period ended December 31, 2006, 7,829,644 shares attributable to outstanding Series A and B Preferred Stock, convertible notes, stock options and warrants were excluded from the calculation of diluted net income per share because if included the effect would be antidilutive.

**NOTE 8. ACCOUNTS PAYABLE, ACCRUED EXPENSES AND OTHER LIABILITIES**

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

|                     | December 31,<br>2006 | September 30,<br>2006 |
|---------------------|----------------------|-----------------------|
| Commissions payable | \$ 1,974,000         | \$ 1,993,000          |
| Legal payable       | 768,000              | 325,000               |
| Other               | 1,699,000            | 1,625,000             |
| Total               | \$ 4,441,000         | \$ 3,943,000          |

**NOTE 9. STOCKHOLDERS' EQUITY**

In the first quarter ended December 31, 2006 the Company received proceeds of approximately \$132,000 from the exercise of outstanding warrants.

**NOTE 10. NEW SUBSIDIARIES**

In the third quarter of fiscal year 2006, the Company formed National Insurance Corporation that will provide fixed insurance products to its clients, including life insurance, disability insurance, long term care insurance and fixed annuities. National Insurance is finalizing the requisite state registrations, and expects to commence active business operations during the current fiscal year.

In the first quarter of fiscal year 2007, the Company formed a new wholly owned subsidiary, National Holdings Mortgage Corporation that will operate a mortgage broker business. National Mortgage is in the process of completing the requisite state registrations, and has not yet commenced business operations.

## 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 7, 2006. 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 December 31, 2006 Compared to Three Months Ended December 31, 2005

The Company's first quarter of fiscal year 2007 resulted in an increase in revenues, and a greater increase in expenses compared to the same period last year. As a result, the Company reported a net loss of \$85,000 compared with net income of \$259,000 for the first quarters of fiscal years 2007 and 2006, respectively. This represents a decline of \$344,000 from the prior period.

|                                      | Three Months Ended<br>December 31, |               | Increase (Decrease) |         |
|--------------------------------------|------------------------------------|---------------|---------------------|---------|
|                                      | 2006                               | 2005          | Amount              | Percent |
| Commissions                          | \$ 8,422,000                       | \$ 7,157,000  | \$ 1,265,000        | 18%     |
| Proprietary trading                  | 2,800,000                          | 1,841,000     | 959,000             | 52%     |
| Market making                        | 447,000                            | -             | 447,000             | n/a     |
| Mark-ups and mark-downs              | 51,000                             | 20,000        | 31,000              | 155%    |
| Net dealer inventory gains           | 3,298,000                          | 1,861,000     | 1,437,000           | 77%     |
| Investment banking                   | 556,000                            | 3,052,000     | (2,496,000)         | (82%)   |
| Interest and dividends               | 566,000                            | 686,000       | (120,000)           | (17%)   |
| Transfer fees and clearance services | 1,010,000                          | 762,000       | 248,000             | 33%     |
| Other                                | 434,000                            | 173,000       | 261,000             | 151%    |
|                                      | \$ 14,286,000                      | \$ 13,691,000 | \$ 595,000          | 4%      |

Total revenues increased \$595,000, or 4%, in the first quarter of fiscal year 2007 to \$14,286,000 from \$13,691,000 in the first quarter of fiscal year 2006. During the first quarter of fiscal year 2007, total trading volume increased by approximately 11%, compared to the first quarter of fiscal year 2006. The increase in revenues and trading volume is due to the stronger securities market in fiscal year 2007 and the Company's re-entry into market making activities. Commission revenue increased \$1,265,000, or 18%, to \$8,422,000 from \$7,157,000 during the first quarter of fiscal year 2007 compared with the same period in fiscal year 2006. Net dealer inventory gains, which includes profits on proprietary trading, market making activities and customer mark-ups and mark-downs, increased \$1,437,000, or 77%, to \$3,298,000 from \$1,861,000 during the first quarter of fiscal year 2007 compared with the same period in fiscal year 2006. The increase is due to the Company's re-entry into market making activities and increased trading activity in foreign securities. During the first quarter of fiscal year 2007, revenues from proprietary trading increased \$959,000, or 52%, to \$2,800,000 from \$1,841,000 in the first quarter of fiscal year 2006, revenues from market making activities increased to \$447,000 from \$0 in the first quarter of fiscal year 2006, and revenues from customer



mark-ups and mark-downs increased \$31,000, or 155%, to \$51,000 from \$20,000 in the first quarter of fiscal year 2006.

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Investment banking revenue decreased \$2,496,000, or 82%, to \$556,000 from \$3,052,000 in the first quarter of fiscal year 2007 compared with the first quarter of fiscal year 2006. The decrease in investment banking revenues is attributable to the Company having completed more investment banking transactions in the first quarter of fiscal year 2006. Interest and dividend income decreased \$120,000 or 17%, to \$566,000 from \$686,000 in the first quarter of fiscal year 2007 compared with the same period last year. The decrease in interest income is attributable to lower margin debit balances resulting from a stricter margin policy imposed by our clearing firms. Transfer fees increased \$248,000, or 33%, to \$1,010,000 in the first quarter of fiscal year 2007 from \$762,000 in the first quarter of fiscal year 2006. The increase is due to the higher trading volume experienced during the current year's quarter.

Other revenue, consisting of asset management fees, miscellaneous transaction fees and trading fees and other investment income, increased \$261,000, or 151%, to \$434,000 from \$173,000 during the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. The increase is due to an increase in fee based assets under management and investment income realized from the Company's venture capital fund.

|                                  | Three Months Ended |               | Increase (Decrease) |         |
|----------------------------------|--------------------|---------------|---------------------|---------|
|                                  | 2006               | 2005          | Amount              | Percent |
| Commission expense related to:   |                    |               |                     |         |
| Commission revenue               | \$ 7,333,000       | \$ 6,273,000  | \$ 1,060,000        | 17%     |
| Net dealer inventory gains       | 2,441,000          | 1,340,000     | 1,101,000           | 82%     |
| Investment banking               | 10,000             | 2,075,000     | (2,065,000)         | (100%)  |
| Commissions                      | 9,784,000          | 9,688,000     | 96,000              | 1%      |
| Employee compensation            | 1,514,000          | 1,292,000     | 222,000             | 17%     |
| Clearing fees                    | 375,000            | 364,000       | 11,000              | 3%      |
| Communications                   | 402,000            | 487,000       | (85,000)            | (17%)   |
| Occupancy and equipment costs    | 735,000            | 676,000       | 59,000              | 9%      |
| Professional fees                | 958,000            | 338,000       | 620,000             | 183%    |
| Interest                         | 104,000            | 110,000       | (6,000)             | (5%)    |
| Taxes, licenses and registration | 179,000            | 145,000       | 34,000              | 23%     |
| Other administrative expenses    | 320,000            | 332,000       | (12,000)            | (4%)    |
|                                  | \$ 14,371,000      | \$ 13,432,000 | \$ 939,000          | 7%      |

In comparison with the 4% increase in total revenues, total expenses increased 7% or \$939,000 to \$14,371,000 for the first quarter of fiscal year 2007 compared to \$13,432,000 in the first quarter of fiscal year 2006. The increase in total expenses is a result of legal fees and costs incurred to settle certain arbitrations. Commission expense, which includes expenses related to commission revenue, net dealer inventory gains and investment banking, increased \$96,000, or 1%, to \$9,784,000 in the first quarter of fiscal year 2007 from \$9,688,000 in the first quarter of fiscal year 2006. Commission expense related to commission revenue increased \$1,060,000, or 17%, to \$7,333,000 in the first quarter of fiscal year 2007 from \$6,273,000 in the first quarter of fiscal year 2006; commission expense related to net dealer inventory gains increased \$1,101,000, or 82%, to \$2,441,000 in the first quarter of fiscal year 2007 from \$1,340,000 in the first quarter of fiscal year 2006; and commission expense related to investment banking decreased \$2,065,000, or almost 100%, to \$10,000 in the first quarter of fiscal year 2007 from \$2,075,000 in the first quarter of fiscal year 2006. Commission expense as a percentage of commission revenues decreased to 87% in the first quarter of fiscal year 2007 from 88% in the first quarter of fiscal year 2006. This decrease is attributable to a decrease in the amortization of advances to registered representatives. Commission expense as a percentage of net dealer inventory gains increased to 74% in the first quarter of fiscal year 2007 from 72% in the first quarter of fiscal year 2006. This increase is attributable to changes in the securities traded, and their related commission payouts. Commission expense as a percentage of investment banking decreased to 2% in the first quarter of fiscal year 2007 from 68% in the first quarter of fiscal year 2006. This decrease is due to the receipt of investment banking revenues in the first quarter of

fiscal year 2007 that did not incur any corresponding commission expense. Commission expense includes the amortization of advances to registered representatives of \$230,000 and \$312,000 for the first quarter of fiscal years 2007 and 2006, respectively. These amounts fluctuate based upon the amounts of advances outstanding and the time period for which the registered representatives have agreed to be affiliated with National Securities.

Employee compensation expense increased \$222,000, or 17%, to \$1,514,000 in the first quarter of fiscal year 2007 from \$1,292,000 in the first quarter of fiscal year 2006. The increase is attributable to new employees hired during fiscal year 2006. Overall, combined commission and employee compensation expense, as a percentage of revenue, decreased slightly to 79% from 80% in the first quarters of fiscal year 2007 and 2006, respectively.

Clearing fees increased \$11,000, or 3%, to \$375,000 in the first quarter of fiscal year 2007 from \$364,000 in the first quarter of fiscal year 2006. The smaller increase in clearing fees as compared to the increase in commission revenue is attributable to higher average commission revenue per ticket in the first quarter of fiscal year 2007.

Communication expenses decreased \$85,000 or 17%, to \$402,000 from \$487,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. The decrease is due to the Company's ability to acquire certain of these services at a lower price. Occupancy costs increased \$59,000, or 9%, to \$735,000 from \$676,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. The increase in occupancy expense is due to costs incurred to transfer certain of the Company's paper files to a digital system. Professional fees increased \$620,000, or 183%, to \$958,000 from \$338,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. The increase in professional fees is a result of legal fees and costs incurred to settle certain arbitrations.

Interest expense decreased \$6,000, or 5%, to \$104,000 from \$110,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. Taxes, licenses and registration increased \$34,000, or 23%, to \$179,000 from \$145,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006. The increase is due to registration incentives provided to certain brokers who became affiliated with the Company in the first quarter of fiscal year 2007. Other administrative expenses decreased \$12,000 or 4% to \$320,000 from \$332,000 in the first quarter of fiscal year 2007 compared to the first quarter of fiscal year 2006.

The Company reported a net loss of \$85,000 in the first quarter of fiscal year 2007 compared to net income of \$259,000 in the first quarter of fiscal year 2006. The net loss attributable to common stockholders in the first quarter of fiscal year 2007 was \$190,000, or \$.04 per common share, as compared to net income attributable to common stockholders in the first quarter of fiscal year 2006 of \$183,000, or \$.04 per common share. The net income attributable to common stockholders for the first quarter of fiscal year 2007 and 2006 reflects \$105,000 and \$76,000, respectively, of cumulative preferred stock dividends on the Company's preferred stock.

## **Liquidity and Capital Resources**

National Securities, as a registered broker-dealer, is subject to the SEC's Uniform Net Capital Rule 15c3-1 that requires the maintenance of minimum net capital. National Securities has elected to use the alternative standard method permitted by the rule. This requires that National Securities maintain minimum net capital equal to the greater of \$250,000 or a specified amount per security based on the bid price of each security for which National Securities is a market maker. At December 31, 2006, National Securities' net capital exceeded the requirement by \$1,665,000.

Advances, dividend payments and other equity withdrawals from the Company's subsidiary 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.

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.

The objective of liquidity management is to ensure that the Company has ready access to sufficient funds to meet commitments, fund deposit withdrawals and efficiently provide for the credit needs of customers.

In April 2005, National Securities entered into a clearing agreement with NFS that became effective in June 2005. In the first quarter of fiscal year 2007, NFS paid National Securities a \$750,000 business credit that has been included in "Accounts Payable, Accrued Expenses and Other Liabilities" in the accompanying consolidated statements of financial condition as of December 31, 2006. 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 for the purpose of providing clearing services that are not provided by NFS. The Company believes that the overall effect of these clearing relationships will be beneficial to the Company's cost structure, liquidity and capital resources.

In the quarter ended December 31, 2006, the Company received proceeds of approximately \$132,000 from the exercise of outstanding warrants.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's primary market risk arises from the fact that it engages in proprietary trading and historically made dealer markets in equity securities. Accordingly, the Company may be required to maintain certain amounts of inventories in order to facilitate customer order flow. The Company 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. The Company is not subject to direct market risk due to changes in foreign exchange rates. However, the Company is subject to market risk as a result of changes in interest rates and equity prices, which are affected by global economic conditions. The Company manages its exposure to market risk by limiting its net long or short positions. Trading and inventory accounts are monitored daily by management and the Company has instituted position limits.

Credit risk represents the amount of accounting loss the Company could incur if counterparties to its 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, the Company maintains more stringent requirements to further reduce its exposure. The Company monitors its exposure to counterparty risk on a daily basis by using credit exposure information and monitoring collateral values. The Company maintains 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.

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The Company monitors its market and credit risks daily through internal control procedures designed to identify and evaluate the various risks to which the Company is exposed. There can be no assurance, however, that the Company's risk management procedures and internal controls will prevent losses from occurring as a result of such risks.

|                        | Long         |    | Short   |    | Net       |
|------------------------|--------------|----|---------|----|-----------|
| Corporate stocks       | \$ 1,921,000 | \$ | 230,000 | \$ | 1,691,000 |
| Corporate bonds        | -            |    | 45,000  |    | (45,000)  |
| Government obligations | 16,000       |    | -       |    | 16,000    |
|                        | \$ 1,937,000 | \$ | 275,000 | \$ | 1,662,000 |

The following table shows the quoted market values of the Company's marketable securities owned ("long"), securities sold, but not yet purchased ("short") and net positions as of December 31, 2006:

#### ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Based on the evaluation of the Company's 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), the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its 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 significant changes in the Company's internal controls or in other factors that could significantly affect those controls and procedures subsequent to the date of our evaluation nor any significant deficiencies or material weaknesses in such disclosure controls and procedures requiring corrective actions.

## **PART II - OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

During the quarter ended December 31, 2006, there were no significant developments in the Company's legal proceedings. For a detailed discussion of the Company's legal proceedings, please refer to Note 5 herein, and the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006.

### **ITEM 1A. RISK FACTORS**

There are no material changes from the risk factors previously disclosed in the Company's Form 10-K for the year ended September 30, 2006.

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

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

None.

### **ITEM 5. OTHER INFORMATION**

On January 24, 2007, the Company and St. Cloud Capital Partners, L.P. ("St. Cloud") amended the 11% convertible promissory note held by St. Cloud in the principal amount of \$850,000 (the "Note") in order to amend the Prepayment Charge (as defined therein) from a charge of 120% of the principal amount of the Note to a sliding charge of between 5% and 1% of the outstanding principal amount of the Note, depending upon the year in which a prepayment is made. Marshall S. Geller, a director of the Company, is a principal of St. Cloud.

### **ITEM 6. EXHIBITS**

#### 4.3 Amendment No. 1 to 11% Convertible Promissory Note.

31.1 Chief Executive Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Chief Financial Officer's Certificate pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Chief Executive Officer's Certificate pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Chief Financial Officer's Certificate pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**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 9, 2007

By: /s/ Mark Goldwasser

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Mark Goldwasser  
President and Chief Executive Officer

February 9, 2007

By: /s/ Robert H. Daskal

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Robert H. Daskal  
Chief Financial Officer