

MCF CORP
Form 10-Q
November 10, 2005

**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 10-Q

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

For the quarterly period ended September 30, 2005

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

For the Transition Period from **to** **.**

Commission file number: 1-15831

MCF CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

11-2936371
(I.R.S. Employer
Identification No.)

600 California Street, 9th Floor
San Francisco, CA
(Address of Principal Executive Offices)

94108
(Zip Code)

(415) 248-5600
(Registrant's Telephone Number, Including Area Code)

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 an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

The number of shares of Registrant's common stock outstanding as of November 9, 2005 was 71,543,974.

Form 10-Q
For the Nine Months Ended September 30, 2005

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MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
Revenue:				
Commissions	\$ 6,943,963	\$ 4,805,372	\$ 20,265,658	\$ 15,770,617
Principal transactions	838,504	155,602	315,770	1,264,122
Investment banking	1,130,351	1,340,750	9,839,450	9,478,007
Other	200,382	1,623	456,595	23,595
Total revenue	9,113,200	6,303,347	30,877,473	26,536,341
Operating expenses:				
Compensation and benefits	6,761,813	5,170,358	23,130,359	18,953,618
Brokerage and clearing fees	688,320	588,099	1,775,597	1,887,754
Professional services	502,093	346,151	1,248,923	979,198
Occupancy and equipment	426,109	219,511	1,159,307	596,383
Communications and technology	496,285	383,015	1,362,638	984,774
Depreciation and amortization	132,606	38,780	367,718	96,641
Other	1,611,465	1,015,887	3,532,117	2,254,516
Total operating expenses	10,618,691	7,761,801	32,576,659	25,752,884
Operating income (loss)	(1,505,491)	(1,458,454)	(1,699,186)	783,457
Interest income	115,316	24,428	305,407	60,145
Interest expense	(15,755)	(20,451)	(49,468)	(97,648)
Income (loss) before income taxes	(1,405,930)	(1,454,477)	(1,443,247)	745,954
Income tax benefit (expense)	(86,814)	425,630	(127,408)	(37,715)
Net income (loss)	\$ (1,492,744)	\$ (1,028,847)	\$ (1,570,655)	\$ 708,239
Earnings (loss) per share:				
Basic	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01
Diluted	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01
Weighted average common shares outstanding:				
Basic	66,905,944	59,919,209	66,226,377	57,094,385
Diluted	66,905,944	59,919,209	66,226,377	76,958,136

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

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MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(unaudited)

	September 30, 2005	December 31, 2004
ASSETS		
Cash and cash equivalents	\$ 14,939,628	\$ 17,459,113
Securities owned:		
Marketable, at fair value	5,907,148	2,342,225
Not readily marketable, at estimated fair value	526,734	259,340
Restricted cash	627,866	625,000
Due from clearing broker	1,234,772	787,862
Accounts receivable, net	1,233,137	1,579,393
Equipment and fixtures, net	1,335,011	1,032,797
Intangible assets, net	404,766	—
Prepaid expenses and other assets	743,886	922,094
Total assets	\$ 26,952,948	\$ 25,007,824
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	\$ 1,239,555	\$ 431,656
Commissions payable	1,703,433	2,840,239
Accrued liabilities	3,175,090	2,962,660
Due to clearing and other brokers	128,053	99,205
Securities sold, not yet purchased	1,566,672	—
Capital lease obligation	401,365	452,486
Convertible notes payable, net	174,157	166,404
Notes payable	1,254,496	1,321,324
Total liabilities	9,642,821	8,273,974
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, Series A—\$0.0001 par value; 2,000,000 shares authorized; 0 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively; aggregate liquidation preference of \$0	—	—
Preferred stock, Series B—\$0.0001 par value; 12,500,000 shares authorized; 8,750,000 shares issued and 0 shares outstanding as of September 30, 2005 and December 31, 2004; aggregate liquidation preference of \$0	—	—
Preferred stock, Series C—\$0.0001 par value; 14,200,000 shares authorized; 11,800,000 shares issued and 0 shares outstanding as of September 30, 2005 and December 31, 2004; aggregate liquidation preference of \$0	—	—
Common stock, \$0.0001 par value; 300,000,000 shares authorized; 71,439,807 and 68,648,627 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively	7,144	6,865
Additional paid-in capital	111,690,495	108,558,892

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Deferred compensation	(3,629,785)	(3,163,876)
Note receivable - Ascend	(519,041)	—
Accumulated deficit	(90,238,686)	(88,668,031)
Total stockholders' equity	17,310,127	16,733,850
Total liabilities and stockholders' equity	\$ 26,952,948	\$ 25,007,824

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

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MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended September 30,	
	2005	2004
Cash flows from operating activities:		
Net income (loss)	\$ (1,570,655)	\$ 708,239
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	367,718	96,641
Restricted stock, stock options and stock warrants granted or modified	1,468,064	795,839
Tax benefits from employee stock options	(10,424)	—
Amortization of discounts on convertible notes payable	7,752	38,938
Amortization of debt issuance costs	—	23,340
Unrealized (gain) loss on securities	(363,187)	115,685
Common stock and stock warrants received for investment banking services	—	(461,933)
Other	(17,132)	22,652
Changes in operating assets and liabilities:		
Marketable and non-marketable securities owned	(1,902,458)	(106,922)
Restricted cash	(2,866)	(275,000)
Due from clearing broker	(446,910)	(478,923)
Accounts receivable	346,256	(73,308)
Prepaid expenses and other assets	196,781	(513,818)
Accounts payable	806,804	276,308
Commissions payable	(1,136,806)	461,975
Accrued liabilities	113,527	311,346
Due to clearing and other brokers	28,848	(45,257)
Net cash provided by (used in) operating activities	(2,114,688)	895,802
Cash flows from investing activities:		
Purchase of equipment and fixtures	(557,617)	(44,831)
Acquisition of Catalyst	(353,882)	—
Investment in MCF Limited Partners I, LP	—	(11,000)
Net cash used in investing activities	(911,499)	(55,831)
Cash flows from financing activities:		
Proceeds from the issuance of common stock	—	6,273,316
Proceeds from the exercise of stock options and warrants	116,682	798,911
Proceeds from the issuance of common stock for ESPP	591,651	313,103
Debt service payments	(201,631)	(94,407)
Net cash provided by financing activities	506,702	7,290,923
Increase (decrease) in cash and cash equivalents	(2,519,485)	8,130,894
Cash and cash equivalents at beginning of period	17,459,113	6,142,958
Cash and cash equivalents at end of period	\$ 14,939,628	\$ 14,273,852

Supplementary disclosure of cash flow information:

Cash paid during the period:

Interest	\$	66,410	\$	65,298
Income taxes	\$	68,161	\$	192,728

Non-cash investing and financing activities:

Preferred stock dividends	\$	—	\$	92,758
Issuance of restricted stock	\$	1,945,973	\$	2,548,606
Issuance of stock options accounted for at intrinsic value	\$	12,000	\$	139,250
Conversion of notes payable to common stock	\$	—	\$	150,000
Purchase of equipment and fixtures on capital lease	\$	—	\$	340,959
Acquisition of Catalyst	\$	74,940	\$	—
Issuance of common stock to Ascend in return for note receivable	\$	500,000	\$	—
Stock warrants issued to common stock investors	\$	—	\$	1,212,399

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

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MCF CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Significant Accounting Policies

Basis of Presentation

The interim financial statements included herein for MCF Corporation, or the Company, have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the financial statements included in this report reflect all normal recurring adjustments that the Company considers necessary for the fair presentation of the results of operations for the interim periods covered and the financial position of the Company at the date of the interim statement of financial condition. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with the Company's 2004 audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

Commission and Principal Transaction Revenue

Commission revenue includes revenue resulting from executing stock exchange-listed securities, over-the counter securities and other transactions as agent for the Company's clients. Principal transactions consist of a portion of dealer spreads attributed to the Company's securities trading activities as principal in NASDAQ-listed and other securities, and include transactions derived from activities as a market-maker. Additionally, principal transactions include gains and losses resulting from market price fluctuations that occur while holding positions in trading security inventory. Revenue generated from trading activities and related expenses are recorded on a trade date basis.

Investment Banking Revenue

Investment banking revenue consists of fees earned from private placements, mergers and acquisitions, management fees for underwritten offerings, financial restructurings and other advisory services provided to clients. Investment banking fees are recorded as revenue when the related service has been rendered, the client is contractually obligated to pay, and its collection is probable. Certain fees for services rendered are recognized as revenue over the service period. As co-manager for registered equity underwriting transactions, management must estimate the Company's share of transaction related expenses incurred by the lead manager in order to recognize revenue. Transaction related expenses are deducted from the underwriting fee and therefore reduces the revenue that is recognized as co-manager. Such amounts are adjusted to reflect actual expenses in the period in which the Company receives the final settlement, typically 90 days following the closing of the transaction.

Stock-Based Compensation

The Company uses the intrinsic value-based method in accordance with Accounting Principles Board, or APB, Opinion No. 25, *Accounting for Stock Issued to Employees*, to account for employee stock-based compensation. Accordingly, compensation cost is recorded on the date of grant to the extent the fair value of the underlying share of common stock exceeds the exercise price for a stock option or the purchase price for a share of common stock. Such compensation cost is amortized on a straight-line basis over the vesting period of the individual award. Pursuant to

Statement of Financial Accounting Standards, or SFAS, No. 123, *Accounting for Stock-Based Compensation*, the Company discloses the pro forma effect of using the fair value method of accounting for employee stock-based compensation. Stock-based awards granted to nonemployees are accounted for pursuant to the fair value method in SFAS No. 123 and Issue No. 96-18 of the Emerging Issues Task Force. The associated expense is measured and recognized by the Company over the period the services are performed by the nonemployee.

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In December 2004, the FASB issued its final standard on accounting for share-based payments, SFAS 123R, *Share-Based Payment*, which addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The statement eliminates the ability to account for share-based compensation transactions using APB Opinion No. 25 and requires instead that such transactions be accounted for using a fair-value-based method. The effective date of SFAS 123R is the beginning of the first annual reporting period that begins after June 15, 2005. Early adoption of SFAS 123R is allowed.

The Company has elected to continue to account for its stock-based compensation in accordance with the provisions of APB Opinion No. 25 as interpreted by FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, and will implement SFAS 123R effective January 1, 2006. The Company expects the adoption of SFAS 123R will have a material impact on the Company's financial position and results of operations.

If the Company was to recognize compensation expense over the relevant service period under the fair value method with respect to stock options granted for the three months and nine months ended September 30, 2005 and all prior periods, net income (loss) would have changed, resulting in pro forma net income (loss) and pro forma net income (loss) per share as presented below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss), as reported	\$ (1,492,744)	\$ (1,028,847)	\$ (1,570,655)	\$ 708,239
Add: Stock-based employee compensation expense included in the reported net income (loss)	18,203	19,203	56,609	73,875
Less: Stock-based employee compensation expense determined under fair value method for all awards	(438,065)	(655,790)	(1,128,276)	(1,402,918)
Pro forma net income (loss)	\$ (1,912,606)	\$ (1,665,434)	\$ (2,642,322)	\$ (620,804)
Net income (loss) per share, as reported:				
Basic	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01
Diluted	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01
Net income (loss) per share, pro forma:				
Basic	\$ (0.03)	\$ (0.03)	\$ (0.04)	\$ 0.01
Diluted	\$ (0.03)	\$ (0.03)	\$ (0.04)	\$ 0.01

The above pro forma disclosures are not necessarily representative of the effects on reported net income or loss for future years.

Reclassification

Certain prior year amounts have been reclassified to conform to current year consolidated financial statement presentation.

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The following is a reconciliation of the basic and diluted net income (loss) available to common stockholders and the number of shares used in the basic and diluted net income (loss) per common share computations for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Net income (loss)	\$ (1,492,744)	\$ (1,028,847)	\$ (1,570,655)	\$ 708,239
Preferred stock dividends	—	(79,562)	—	(92,758)
Net income (loss) available to common stockholders - basic	(1,492,744)	(1,108,409)	(1,570,655)	615,481
Interest and dividends on dilutive common shares	—	—	—	—
Net income available to common stockholders - diluted	\$ (1,492,744)	\$ (1,108,409)	\$ (1,570,655)	\$ 615,481
Weighted-average number of common shares - basic	66,905,944	59,919,209	66,226,377	57,094,385
Exercise or conversion of all potentially dilutive common shares outstanding	—	—	—	19,863,751
Weighted-average number of common shares - diluted	66,905,944	59,919,209	66,226,377	76,958,136
Basic net income (loss) per common share	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01
Diluted net income (loss) per common share	\$ (0.02)	\$ (0.02)	\$ (0.02)	\$ 0.01

Basic earnings per share is computed by dividing net income (loss), less dividends on preferred stock, by the weighted average number of common shares outstanding, excluding unvested restricted stock. Diluted earnings per share is calculated by dividing net income, less dividends on preferred stock plus interest and dividends on dilutive securities, by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming exercise or conversion of all potentially dilutive common shares outstanding, including unvested restricted stock. Diluted loss per share is unchanged from basic loss per share for the three months ended September 30, 2005 and 2004 and the nine months ended September 30, 2005 because the addition of common shares that would be issued assuming exercise or conversion would be anti-dilutive.

Shares used in the diluted net income per share computation in the above table include the dilutive impact of the Company's stock options and warrants. The impact of the Company's stock options and warrants on shares used for the diluted earnings per share computation is calculated based on the average share price of the Company's common stock for each period using the treasury stock method. Under the treasury stock method, the tax-effected proceeds that would be hypothetically received from the exercise of all stock options and warrants with exercise prices below the

average share price of the Company's common stock are assumed to be used to repurchase shares of the Company's common stock. The dilutive impact of the Company's stock options and warrants was calculated using an average price of the Company's common stock of \$1.90 per share for the nine months ended September 30, 2004. Because the Company reported a net loss during three months ended September 30, 2005 and 2004 and the nine months ended September 30, 2005, the Company excluded the impact of all stock options and warrants in the computation of dilutive earnings per share, as their effect would be anti-dilutive.

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The Company excludes all potentially dilutive securities from its diluted net income (loss) per share computation when their effect would be anti-dilutive. The following common stock equivalents were excluded from the earnings per share computation, as their inclusion would have been anti-dilutive:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Stock options and warrants excluded due to the exercise price exceeding the average fair value of the Company's common stock during the period	9,983,740	6,573,013	8,123,311	5,778,264
Weighted average restricted stock, stock options and stock warrants, calculated using the treasury stock method, that were excluded due to the Company reporting a net loss during the period	16,142,510	18,848,525	17,655,135	—
Weighted average shares issuable upon conversion of the convertible notes payable	1,000,000	2,500,000	1,000,000	2,532,058
Weighted average shares issuable upon conversion of the convertible preferred stock	—	29,781	—	275,009
Weighted average shares contingently issuable	1,470,974	—	846,876	—
Total common stock equivalents excluded from diluted net income per share	28,597,224	27,951,319	27,625,322	8,585,331

3. Regulatory Requirements

Merriman Curhan Ford & Co. is a broker-dealer subject to Rule 15c3-1 of the Securities and Exchange Commission, which specifies uniform minimum net capital requirements, as defined, for their registrants. As of September 30, 2005, Merriman Curhan Ford & Co. had regulatory net capital, as defined, of \$10,389,000 exceeded the amount required by \$9,766,000. Merriman Curhan Ford & Co. is exempt from Rules 15c3-3 and 17a-13 under the Securities Exchange Act of 1934 because it does not carry customer accounts, nor does it hold customer securities or cash.

4. Acquisition of Catalyst Financial Planning and Investment Management, Inc.

On February 28, 2005, the Company acquired Catalyst Financial Planning & Investment Management, Inc., or Catalyst, a registered investment advisor with over \$100 million in assets under management. This is the Company's first acquisition of a registered investment advisor as the Company executes on its plan to build a fee-based, recurring revenue business. The Company plans to introduce new potential clients to Catalyst from the corporate and venture services group as well as the investment banking department.

The purchase consideration for Catalyst consists of both cash and common stock that will be paid over a three year period. The Company paid to the sole shareholder of Catalyst, or Catalyst Shareholder, \$330,433 as initial consideration at the closing. The Company has also agreed to issue to the Catalyst Shareholder up to 925,325 shares of

common stock over three years based upon the amount of revenue growth for Catalyst. The payment of these shares is subject to specified conditions. Such additional amounts will be recorded as compensation expense, if any, when such amounts become due which are contingent upon the continued employment of the Catalyst Shareholder. The Company acquired 100% of the voting stock in Catalyst. The results of operations for Catalyst are included in the Company's consolidated financial statements beginning March 1, 2005.

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5. Ascend Services Ltd.

On May 4, 2005, MCF Corporation entered into a strategic alliance with Ascend Services Ltd., or Ascend. In conjunction with this alliance, Ascend has entered into a stock purchase agreement with the Company. Ascend has also engaged the Company as an investment advisor for its short-term high credit-quality fixed income portfolio. The Company issued 1,078,749 shares of its common stock and Ascend has issued an unsecured promissory note payable to the Company in the amount of \$1.5 million. The shares will be held initially in escrow. Upon Ascend achieving specified milestones, the 1,078,749 shares of common stock will be released from escrow in three installments of 359,583 shares each and provided to Ascend. Upon satisfaction of the conditions specified in the escrow agreement and simultaneous with the release of the related stock certificates, the related amount of the promissory note shall become effective and start accruing interest. The promissory note accrues interest at 10% per annum and matures on February 28, 2006. The Company will record the promissory note as a reduction of stockholders' equity until Ascend repays the note.

On May 15, 2005, the Company released the first installment of 359,583 shares of common stock to Ascend while the related promissory note with a face value of \$500,000 became effective. Interest income from the note amounted to \$19,000 during the nine months ended September 30, 2005.

6. Income Taxes

The income tax expense for the nine months ended September 30, 2005 represented state taxes while the income tax expense for 2004 reflected taxes calculated for federal and state tax purposes. The income tax expense for 2005 and 2004 reflects the utilization of some of the Company's net operating loss carryforwards.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as "may," "will," "should," "expects," "anticipates," "targets," "goals," "projects," "intends," "plans," "believes," "seeks," "estimates," "continue," variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances, are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are referred to risks and uncertainties identified under "Risk Factors" beginning on Page 18 and elsewhere herein. We undertake no obligation to revise or update publicly any forward-looking statements for any reason.

Company Overview

MCF Corporation is a financial services holding company that provides investment research, capital markets services, corporate and venture services, investment banking, asset management, and wealth management through its operating subsidiaries, Merriman Curhan Ford & Co., MCF Asset Management, LLC, and MCF Wealth Management, LLC. MCF Asset Management, LLC and MCF Wealth Management, LLC are two recently formed businesses that are predicated on fee-based, recurring revenue models.

Merriman Curhan Ford & Co. is a securities broker-dealer and investment bank focused on fast-growing companies and growth-oriented institutional investors. It provides investment research, brokerage and trading services primarily to institutions, as well as advisory and investment banking services to corporate clients. Its mission is to become a leader in the researching, advising, financing and trading of fast growing companies. Merriman Curhan Ford & Co. is registered with the Securities and Exchange Commission as a broker-dealer and is a member of the National Association of Securities Dealers, Inc. and Securities Investors Protection Corporation.

Business Environment

The business environment during the third quarter 2005 was somewhat favorable due to a combination of factors including an expanding U.S. economy, continued low interest rates and low inflation. Favorable job reports and an active housing market provided ongoing support to economic activity. The unemployment rate dropped to its lowest level since August 2001. Oil prices, however, soared during the quarter raising concerns about the effect on overall economic activity. The Federal Reserve Board continued its measured pace of interest rate increases, raising the federal funds rate to 3.75%. The small-cap growth equity indices applicable to the companies that we serve were mostly flat during the third quarter and for the year-to-date.

Our securities broker-dealer and investment banking activities are linked to the capital markets. In addition, our business activities are focused in the consumer growth, healthcare, specialty growth and technology sectors. By their nature, our business activities are highly competitive and are not only subject to general market conditions, volatile trading markets and fluctuations in the volume of market activity, but also to the conditions affecting the companies and markets in our areas of focus.

Fluctuations in revenue also occur due to the overall level of market activity, which, among other things, affects the flow of investment dollars and the size, number and timing of investment banking transactions. In addition, a

downturn in the level of market activity can lead to a decrease in brokerage commissions. Therefore, revenue in any particular period may vary significantly from year to year.

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Revenue recognized in the third quarter 2005 was \$9,113,000, an increase of 45% over the third quarter of 2004. Commission revenue grew by 45% over 2004 while investment banking revenue declined by 16% from the prior year. We incurred a net loss of \$0.02 per diluted share for the three months ended September 30, 2005 and 2004. Our profitability was negatively impacted by the decline in our investment banking revenue and increased costs associated with marketing, recruiting and other operating expenses. We continued to hire experienced professionals during the third quarter across our various departments, including sales and trading, research, investment banking and revenue support. During the first nine months of 2005, we have grown our head count by 28% and increased our marketing expenditures which we believe will help build our brand identity and ultimately lead to higher revenue in future periods, while remaining cash flow positive as measured by EBITDA. Additionally, we are continuing our business development activities related to our asset management and wealth management businesses.

Results of Operations

The following table sets forth a summary of financial highlights for the three months and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue	\$ 9,113,200	\$ 6,303,347	\$ 30,877,473	\$ 26,536,341
Operating expenses	10,618,691	7,761,801	32,576,659	25,752,884
Operating income (loss)	(1,505,491)	(1,458,454)	(1,699,186)	783,457
Net income (loss)	(1,492,744)	(1,028,847)	(1,570,655)	708,239
EBITDA	\$ (1,056,349)	\$ (1,109,558)	\$ 136,596	\$ 1,675,937
Adjustments:				
Interest income	115,316	24,428	305,407	60,145
Interest expense	(15,755)	(20,451)	(49,468)	(97,648)
Income tax expense	(86,814)	425,630	(127,408)	(37,715)
Depreciation and amortization	(132,606)	(38,780)	(367,718)	(96,641)
Amortization of stock-based compensation	(316,536)	(310,116)	(1,468,064)	(795,839)
Net income (loss)	\$ (1,492,744)	\$ (1,028,847)	\$ (1,570,655)	\$ 708,239

Our revenue during the third quarter 2005 increased \$2,810,000 or 45%, from the corresponding period in 2004 reflecting the continued growth of our sales and trading activities, partially offset by lower investment banking revenue during the period. We incurred a net loss of \$1,493,000 during the third quarter 2005 as compared to net loss of \$1,029,000 during the third quarter 2004. Our earnings before interest, taxes, depreciation and amortization, or EBITDA, for the third quarter 2005 and 2004 were (\$1,056,000) and (\$1,110,000), respectively. The decline in profitability during the third quarter of 2005 as compared to the third quarter of 2004 resulted from the drop in our investment banking revenue which produces higher operating margins compared to sales and trading revenue, and higher marketing, recruiting and other operating expenses. Our second annual Investor Summit conference was held during the third quarter which resulted in significant expense. We believe that the conference is critical to our development of investment banking mandates, as well as creating brand identity for our firm.

EBITDA (earnings before interest, taxes, depreciation and amortization) is a key metric we use in evaluating our financial performance. EBITDA is considered a non-GAAP financial measure as defined by Regulation G

promulgated by the SEC pursuant to the Securities Act of 1933, as amended. We consider EBITDA an important measure of our ability to generate cash flows to service debt, fund capital expenditures and fund other corporate investing and financing activities. EBITDA eliminates the non-cash effect of tangible and intangible asset depreciation and stock-based amortization. EBITDA should be considered in addition to, rather than as a substitute for, pre-tax income, net income and cash flows from operating activities.

Table of Contents**Commissions and Principal Transactions Revenue**

Our broker-dealer activity includes the following:

- **Commissions** - Commissions include revenue resulting from executing stock trades for exchange-listed securities, over-the-counter securities and other transactions as agent.
- **Principal Transactions** - Principal transactions consist of a portion of dealer spreads attributed to our securities trading activities as principal in NASDAQ-listed and other securities, and include transactions derived from our activities as a market-maker. Additionally, principal transactions include gains and losses resulting from market price fluctuations that occur while holding positions in our trading security inventory.

The following table sets forth our revenue and several operating metrics which we utilize in measuring and evaluating performance and the results of our sales and trading activity operations:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue:				
Commissions	\$ 6,943,963	\$ 4,805,372	\$ 20,265,658	\$ 15,770,617
Principal transactions:				
Customer principal transactions, proprietary trading and market making	1,037,478	207,936	271,230	493,236
Investment portfolio	(198,974)	(52,334)	44,540	770,886
Total principal transactions revenue	\$ 838,504	\$ 155,602	\$ 315,770	\$ 1,264,122

Transaction Volumes:

Number of shares traded	293,312,000	149,110,000	757,226,000	592,880,000
Number of active clients	426	351	559	526

Commission revenue increased by \$2,139,000, or 45%, during the third quarter of 2005 as compared to the third quarter of 2004. This growth is primarily attributable to the hiring of additional sales and research professionals that resulted in the increase in the number of active client accounts and the deeper penetration of these accounts during 2005 as compared to 2004. During the three months ended September 30, 2005, no single sales and trading customer accounted for more than 10% of our revenue, while one sales and trading customer accounted for 13% of our revenue during the three months ended September 30, 2004.

Principal transaction gains, including market making and proprietary trading for our own account, amounted to \$839,000 during the three months ended September 30, 2005, as compared to \$156,000 during the three months ended September 30, 2004. During the third quarter of 2005, most of our principal transactions revenue was attributable to gains from our proprietary trading and market making activities which were partially offset by the decline in value of our investment portfolio which primarily consists of stock warrants and restricted common stock that we earn in connection with our investment banking activity.

Table of Contents**Investment Banking Revenue**

Our investment banking activity includes the following:

- Capital Raising - Capital raising includes private placements of equity and debt instruments and underwritten public offerings.
- Financial Advisory. Financial advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, restructurings and spin-offs.

The following table sets forth our revenue and transaction volumes from our investment banking activities during the three months and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Revenue:				
Capital raising	\$ 784,911	\$ 472,030	\$ 9,288,885	\$ 7,635,827
Financial advisory	345,440	868,720	550,565	1,842,180
Total investment banking revenue	\$ 1,130,351	\$ 1,340,750	\$ 9,839,450	\$ 9,478,007
Transaction Volumes:				
Public offerings:				
Capital underwritten	\$ 42,100,000	\$ 20,097,000	\$ 183,325,000	\$ 245,279,000
Number of transactions	2	1	5	6
Private placements:				
Capital raised	\$ 3,000,000	\$ 5,500,000	\$ 220,419,000	\$ 119,950,000
Number of transactions	1	1	10	10

Investment banking revenue decreased by \$210,000, or 16%, during the third quarter of 2005 as compared to the third quarter of 2004. Our investment banking practice was unable to close a significant amount of mandated business during the third quarter 2005. This was due in part to a senior management transition in the investment banking department. This transition was completed at the beginning of the third quarter with the hiring of a new head of investment banking. We closed two equity underwritten transaction and one private placement transactions during the third quarter of 2005, compared to one underwritten and one private placement transactions during the third quarter 2004. During the three months ended September 30, 2005, no single investment banking customer accounted for more than 10% of our revenue, while one investment banking customer accounted for 12% of our revenue for the three months ended September 30, 2004.

Compensation and Benefits Expenses

Compensation and benefits expense represents the majority of our operating expenses and includes incentive compensation paid to sales and trading and investment banking professionals, as well as discretionary bonuses, salaries and wages, and stock-based compensation. Incentive compensation varies primarily based on revenue production. Discretionary bonuses paid to research analysts also vary with commission revenue production but includes other qualitative factors as well. Salaries, payroll taxes and employee benefits are relatively fixed in nature.

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The following table sets forth the major components of our compensation and benefits for the three months and nine months ended September 30, 2005 and 2004:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
Incentive compensation and discretionary bonuses	\$ 3,308,472	\$ 2,784,053	\$ 12,702,930	\$ 12,338,402
Salaries and wages	2,522,864	1,551,986	6,810,614	4,180,324
Stock-based compensation	316,536	300,267	1,468,065	785,988
Payroll taxes, benefits and other	613,941	534,052	2,148,750	1,648,904
Total compensation and benefits	\$ 6,761,813	\$ 5,170,358	\$ 23,130,359	\$ 18,953,618
Total compensation and benefits as a percentage of revenue	74%	82%	75%	71%
Cash compensation and benefits as a percentage of revenue	71%	77%	70%	68%

The amount of compensation and benefits that we incur during a given period is largely dependent upon the level of revenue recognized during that period, since most of our employees are paid based on a percentage of the revenue attributed to their efforts. During the three months and nine months ended September 30, 2005, compensation and benefits expense increased by \$1,591,000, or 31%, and \$4,177,000, or 22%, as compared to the corresponding period in 2004, respectively.

Cash compensation and benefits expense as a percentage of revenue increased to 70% during the first nine months of 2005 as compared to 68% during the first nine months of 2004. This increase is due in part to higher salaries and wages resulting from increased headcount in anticipation of our revenue growth. We have grown our headcount at a measured pace during 2004 and 2005. Our headcount has increased from 109 at September 30, 2004 to 148 at September 30, 2005. The increase in stock-based compensation during 2005 reflects our decision to grant restricted stock to new and existing employees. During the three months ended September 30, 2005 and 2004, one sales professional accounted for 15% and 20% of our revenue, respectively.

Other Operating Expenses

Brokerage and clearing fees include trade processing expenses that we pay to our clearing broker and execution fees that we pay to floor brokers and electronic communication networks. Merriman Curhan Ford & Co. is a fully-disclosed broker-dealer, which has engaged a third party clearing broker to perform all of the clearance functions. The clearing broker-dealer processes and settles the customer transactions for Merriman Curhan Ford & Co. and maintains the detailed customer records. Additionally, security trades are executed by third-party broker-dealers and electronic trading systems. These expenses are almost entirely variable with commission revenue and the volume of brokerage transactions. Despite the increase in commission revenue during the nine months ended September 30, 2005 as compared to the corresponding period in 2004, brokerage and clearing fees decreased by \$112,000, or 6%, from the first nine months of 2004. This reflected the cost savings that we achieved by negotiating lower fees with our new clearing broker during the fourth quarter 2004.

Professional services expense includes legal fees, accounting fees, expenses related to investment banking transactions and various consulting fees. Many of these expenses, such as legal and accounting fees, are to a large extent fixed in nature. During the three months and nine months ended September 30, 2005, professional services expense increased by \$156,000, or 45%, and \$270,000, or 28%, as compared to the corresponding periods in 2004, respectively. This increase in professional services expense primarily reflected higher legal costs related to various corporate and investment banking activities.

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Occupancy and equipment includes rental costs for our office facilities and equipment, as well as equipment, software and leasehold improvement expenses. These expenses are largely fixed in nature and tend to increase as we hire additional employees. During the three months and nine months ended September 30, 2005, occupancy and equipment expense increased by \$207,000, or 94%, and \$563,000, or 94%, as compared to the corresponding periods in 2004, respectively. The increase in occupancy and equipment expense resulted mostly from higher office rents. During 2004, we moved into larger office spaces in San Francisco, New York, Boston, Los Angeles and Portland to accommodate our growth in business and headcount.

Communications and technology expense includes voice, data and Internet service fees, and data processing costs. Historically, these costs have increased as we hire additional employees. During the three months and nine months ended September 30, 2005, communications and technology expense increased by \$113,000, or 30%, and \$378,000, or 38%, as compared to the corresponding periods in 2004, respectively. The increase in communications and technology expense was due to higher telephone and data service fees incurred in our sales and trading operations. The higher telephone and data service charges are the result of increased headcount and the expansion of our offices, as well as higher costs to upgrade our information technology infrastructure.

Depreciation and amortization expense primarily relate to the depreciation of our computer equipment and leasehold improvements. Depreciation and amortization is mostly fixed in nature. During the three months and nine months ended September 30, 2005, depreciation and amortization expense increased by \$94,000, or 242%, and \$271,000, or 281%, as compared to the corresponding periods in 2004, respectively. The increase in depreciation and amortization expense was due to increased capital expenditures, including leasehold improvements to our San Francisco and New York offices during 2004, to facilitate our growth and expansion.

Other operating expense includes professional liability and property insurance, recruiting, investor conferences, travel and entertainment, printing and copying, business licenses and taxes, office supplies and other miscellaneous office expenses. During the three months and nine months ended September 30, 2005, other operating expense increased by \$596,000, or 59%, and \$1,278,000, or 57%, as compared to the corresponding period in 2004, respectively. The increase in other operating expense was attributed to higher costs associated with our annual investor conference, recruiting costs, higher travel expenses, and various business taxes.

Income Tax Expense

The income tax expense for the nine months ended September 30, 2005 represented state taxes while the income tax expense for 2004 reflected taxes calculated for Federal and state tax purposes. The income tax expense for 2005 and 2004 reflects the utilization of some of the Company's net operating loss carryforwards.

Off-Balance Sheet Arrangements

We were not a party to any off-balance sheet arrangements during the nine months ended September 30, 2005. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities and structured finance entities.

Critical Accounting Policies and Estimates

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to the valuation of securities owned and deferred tax assets. We base our

estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

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Valuation of Securities Owned

Securities owned that are not readily marketable are carried at fair value, with the accompanying gains and losses reflected in our results of operations. The fair value of securities, for which a quoted market or dealer price is not available, is based on management's estimates. Among the factors considered by management in determining the fair value of securities are the cost of the securities, terms and liquidity, developments since the acquisition of the securities, the sales price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yield that are publicly traded, and other factors generally pertinent to the valuation of securities. The fair value of these securities is subject to a high degree of volatility and may be susceptible to significant fluctuation in the near term. Where available, we use prices from independent sources such as listed market prices or dealer quotations.

Revenue Recognition

We recognize brokerage revenue once the trade is consummated and the earnings process is complete. Investment banking revenue consists of fees earned from private placements, mergers and acquisitions, management fees for underwritten offerings, financial restructurings and other advisory services provided to clients. Investment banking fees are recorded as revenue when the related service has been rendered, the client is contractually obligated to pay, and its collection is probable. Certain fees received in advance of services rendered are deferred and recognized as revenue over the service period. Transaction-related expenses to date have been expensed as incurred. As co-manager for registered equity underwriting transactions, we must estimate the transaction related expenses incurred by the lead manager in order to recognize revenue. Transaction related expenses are deducted from the underwriting fee and therefore reduces the revenue that we will recognize as co-manager. Such amounts are adjusted to reflect actual expenses in the period in which we receive the final settlement, typically 90 days following the closing of the transaction.

Stock-Based Compensation

As part of our compensation of employees, we may use stock-based compensation, including stock options, restricted stock and other stock-based awards. Compensation related to restricted stock and other stock-based awards is amortized over the vesting period of the award, which is generally three to four years, and is included in our results of operations as compensation expense. Accounting principles generally accepted in the United States allow alternative methods of accounting for stock options, including an "intrinsic value" method and a "fair value" method. The intrinsic value method is intended to reflect the impact of stock options on stockholders based on the appreciation in the stock option over time, generally driven by financial performance. The fair value method requires an estimate of the value of stock options to be recognized as compensation expense over the vesting period of the awards. Currently, we use the intrinsic value method and do not recognize the impact of these awards as compensation expense. Accordingly, we provide disclosure of the impact of the estimated fair value of the stock options on our compensation and reported income in the notes to the consolidated financial statements. In determining the estimated fair value of stock options, we use the Black-Scholes option-pricing model, which requires judgment regarding certain assumptions, including the expected life of the options granted, dividend yields and stock volatility.

Deferred Tax Valuation Allowance

We account for income taxes in accordance with the provision of SFAS No. 109, *Accounting for Income Taxes*, which requires the recognition of deferred tax assets and liabilities at tax rates expected to be in effect when these balances reverse. Future tax benefits attributable to temporary differences are recognized to the extent that the realization of such benefits is more likely than not. We have concluded that it is more likely than not that our deferred tax assets as

of September 30, 2005 and 2004 will not be realized based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income. Should we determine that we will be able to realize all or part of the deferred tax asset in the future, an adjustment to the deferred tax asset will be recorded in the period such determination is made.

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Liquidity and Capital Resources

Historically, we have satisfied our liquidity and regulatory capital needs through the issuance of equity and debt securities. As of September 30, 2005, our short-term and long-term debt amounted to \$1,830,000, while our stockholders' equity was \$17,310,000. Our principal assets consist of cash and cash equivalents, marketable securities held for trading purposes, restricted cash, receivables and equipment and fixtures. As of September 30, 2005, liquid assets consisted primarily of cash and cash equivalents of \$14,940,000 and marketable securities of \$5,907,000, for a total of \$20,847,000. Merriman Curhan Ford & Co., as a broker-dealer, is subject to Rule 15c3-1 of the Securities Exchange Act of 1934, which specifies uniform minimum net capital requirements, as defined, for their registrants. As of September 30, 2005, Merriman Curhan Ford & Co. had regulatory net capital, as defined, of \$10,389,000, which exceeded the amount required by \$9,766,000.

During the nine months ended September 30, 2005, our earnings before interest, taxes, depreciation and amortization, or EBITDA, were \$137,000. We consider EBITDA an important measure of our ability to generate cash flows to service debt, fund capital expenditures and fund other corporate investing and financing activities. EBITDA eliminates the non-cash effect of tangible and intangible asset depreciation and stock-based amortization. We have provided a reconciliation of EBITDA to net income (loss) for the three months and nine months ended September 30, 2005 on page 11. EBITDA should be considered in addition to, rather than as a substitute for, pre-tax income, net income and cash flows from operating activities. Cash flow used in our operating activities during the first nine months of 2005 was \$2,115,000 and includes the increase in operating assets, such as marketable securities and due from clearing broker, by \$1,809,000 and the reduction of operating liabilities, such as commissions payable and accrued liabilities, by \$188,000.

Cash used in investing activities during the nine months ended 2005 was \$911,000, reflecting the acquisition of Catalyst and the purchase of equipment and fixtures. Cash provided by financing activities was \$507,000 during the first nine months of 2005 due primarily to the proceeds from the issuance of common stock for the Employee Stock Purchase Plan and exercises of stock options and stock warrants.

We believe that our existing cash balances and investments will be sufficient to meet our liquidity and capital spending requirements, both for the next twelve months as well as for the long-term. However, we may require additional capital investment to fund our working capital if we incur future operating losses. We cannot be certain that additional debt or equity financing will be available when required or, if available, that we can secure it on terms satisfactory to us.

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Risk Factors

Investing in our securities involves a high degree of risk. In addition to the other information contained in this quarterly report, including reports we incorporate by reference, you should consider the following factors before investing in our securities.

It is difficult to evaluate our business and prospects because we have a limited operating history.

We began actively engaging in providing securities brokerage and investment banking services in January 2002. This was an entirely new business for us, and was a complete break with our previous business, the bandwidth brokerage business. Accordingly, we have a limited operating history on which to base an evaluation of our business and prospects. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by fast growing companies in their early stage of development. We cannot assure you that we will be successful in addressing these risks and our failure to do so could have a material adverse effect on our business and results of operations.

We may not be able to maintain a positive cash flow and profitability.

Our ability to maintain a positive cash flow and profitability depends on our ability to generate and maintain greater revenue while incurring reasonable expenses. This, in turn, depends, among other things, on the development of our securities brokerage and investment banking business, and we may be unable to maintain profitability if we fail to do any of the following:

- establish, maintain and increase our client base;
- manage the quality of our services;
- compete effectively with existing and potential competitors;
- further develop our business activities;
- manage expanding operations; and
- attract and retain qualified personnel.

We cannot be certain that we will be able to sustain or increase a positive cash flow and profitability on a quarterly or annual basis in the future. Our inability to maintain profitability or positive cash flow could result in disappointing financial results, impede implementation of our growth strategy or cause the market price of our common stock to decrease. Accordingly, we cannot assure you that we will be able to generate the cash flow and profits necessary to sustain our business expectations, which makes our ability to successfully implement our business plan uncertain.

Because we are a developing company, the factors upon which we are able to base our estimates as to the gross revenue and the number of participating clients that will be required for us to maintain a positive cash flow and any additional financing that may be needed for this purpose are unpredictable. For these and other reasons, we cannot assure you that we will not require higher gross revenue, and an increased number of clients, securities brokerage and investment banking transactions, and/or more time in order for us to complete the development of our business that we believe we need to be able to cover our operating expenses, or obtain the funds necessary to finance this development. It is more likely than not that our estimates will prove to be inaccurate because actual events more often than not differ from anticipated events. Furthermore, in the event that financing is needed in addition to the amount that is required

for this development, we cannot assure you that such financing will be available on acceptable terms, if at all.

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The markets for securities brokerage and investment banking services are highly competitive. If we are not able to compete successfully against current and future competitors, our business and results of operations will be adversely affected.

We are engaged in the highly competitive financial services and investment industries. We compete with large Wall Street securities firms, securities subsidiaries of major commercial bank holding companies, U.S. subsidiaries of large foreign institutions, major regional firms, smaller niche players, and those offering competitive services via the Internet. Many competitors have greater personnel and financial resources than we do. Larger competitors are able to advertise their products and services on a national or regional basis and may have a greater number and variety of distribution outlets for their products, including retail distribution. Discount and Internet brokerage firms market their services through aggressive pricing and promotional efforts. In addition, some competitors have much more extensive investment banking activities than we do and therefore, may possess a relative advantage with regard to access to deal flow and capital.

Increased pressure created by any current or future competitors, or by our competitors collectively, could materially and adversely affect our business and results of operations. Increased competition may result in reduced revenue and loss of market share. Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service or marketing decisions or acquisitions that also could materially and adversely affect our business and results of operations. We cannot assure you that we will be able to compete successfully against current and future competitors. In addition, new technologies and the expansion of existing technologies may increase the competitive pressures on us.

We may experience reduced revenue due to declining market volume, securities prices and liquidity, which can also cause counterparties to fail to perform.

Our revenue may decrease in the event of a decline in the market volume of securities transactions, prices or liquidity. Declines in the volume of securities transactions and in market liquidity generally result in lower revenue from trading activities and commissions. Lower price levels of securities may also result in a reduction in our revenue from corporate finance fees, as well as losses from declines in the market value of securities held by us in trading. Sudden sharp declines in market values of securities can result in illiquid markets and the failure of counterparties to perform their obligations, as well as increases in claims and litigation, including arbitration claims from customers. In such markets, we may incur reduced revenue or losses in our principal trading, market-making, investment banking, and advisory services activities.

We may experience significant losses if the value of our marketable security positions deteriorates.

We conduct securities trading, market-making and investment activities for our own account, which subjects our capital to significant risks. These risks include market, credit, counterparty and liquidity risks, which could result in losses for us. These activities often involve the purchase, sale or short sale of securities as principal in markets that may be characterized as relatively illiquid or that may be particularly susceptible to rapid fluctuations in liquidity and price. Trading losses resulting from such trading could have a material adverse effect on our business and results of operations.

We may experience significant fluctuations in our quarterly operating results due to the nature of our business and therefore may fail to meet profitability expectations.

Our revenue and operating results may fluctuate from quarter to quarter and from year to year due to a combination of factors, including:

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- the level of institutional brokerage transactions and the level of commissions we receive from those transactions;
- the valuations of our principal investments;
- the number of capital markets transactions completed by our clients, and the level of fees we receive from those transactions; and
- variations in expenditures for personnel, consulting and legal expenses, and expenses of establishing new business units, including marketing and technology expenses.

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We record revenue from a capital markets advisory transaction only when we have rendered the services, the client is contractually obligated to pay and collection is probable; generally, most of the fee is earned only upon the closing of a transaction. Accordingly, the timing of our recognition of revenue from a significant transaction can materially affect our quarterly operating results.

We have registered one of our subsidiaries as a securities broker-dealer and, as such, are subject to substantial regulations. If we fail to comply with these regulations, our business will be adversely affected.

Because we have registered Merriman Curhan Ford & Co. with the Securities and Exchange Commission, or SEC, and the National Association of Securities Dealers, Inc., or NASD, as a securities broker-dealer, we are subject to extensive regulation under federal and state laws, as well as self-regulatory organizations. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets rather than protection of creditors and stockholders of broker-dealers. The Securities and Exchange Commission is the federal agency charged with administration of the federal securities laws. Much of the regulation of broker-dealers, however, has been delegated to self-regulatory organizations, such as the NASD and national securities exchanges. The NASD is our primary self-regulatory organization. These self-regulatory organizations adopt rules, which are subject to SEC approval, that govern the industry and conduct periodic examinations of member broker-dealers. Broker-dealers are also subject to regulation by state securities commissions in the states in which they are registered. The regulations to which broker-dealers are subject cover all aspects of the securities business, including net capital requirements, sales methods, trading practices among broker-dealers, capital structure of securities firms, record keeping and the conduct of directors, officers and employees. The SEC and the self-regulatory bodies may conduct administrative proceedings, which can result in censure, fine, suspension or expulsion of a broker-dealer, its officers or employees. If we fail to comply with these rules and regulations, our business may be materially and adversely affected.

The regulatory environment in which we operate is also subject to change. Our business may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, other United States or foreign governmental regulatory authorities or the NASD. We also may be adversely affected by changes in the interpretation or enforcement of existing laws and rules by these governmental authorities and the NASD.

Our business may suffer if we lose the services of our executive officers or operating personnel.

We depend on the continued services and performance of D. Jonathan Merriman, our Chairman and Chief Executive Officer, for our future success. We currently have an employment agreement with Mr. Merriman, which ends on January 1, 2007, but can be terminated by either party on 60 days' notice. The agreement contains provisions that obligate us to make certain payments to Mr. Merriman and substantially reduce vesting periods of options granted to him if we should terminate him without cause or certain events resulting in a change of control of our Board were to occur.

In addition to Mr. Merriman, we are currently managed by a small number of key management and operating personnel. We do not maintain "key man" insurance on any employee. Our future success depends, in part, on the continued service of our key executive, management and technical personnel, and our ability to attract highly skilled employees. Our business could be harmed if any key officer or employee were unable or unwilling to continue in his or her current position. From time to time we have experienced, and we expect to continue to experience, difficulty in hiring and retaining highly skilled employees. Competition for employees in our industry is significant. If we are unable to retain our key employees or attract, integrate or retain other highly qualified employees in the future, such failure may have a material adverse effect on our business and results of operations.

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Our business is dependent on the services of skilled professionals, and may suffer if we can not recruit or retain such skilled professionals.

During the nine months ended September 30, 2005, one sales professional accounted for 13% of our revenue. We have a number of revenue producers employed by our securities brokerage and investment banking subsidiary. We do not have employment contracts with these employees. The loss of one or more of these employees could adversely affect our business and results of operations.

Our compensation structure may negatively impact our financial condition if we are not able to effectively manage our expenses and cash flows.

We are able to recruit and retain investment banking, research and sales and trading professionals, in part because our business model provides that we pay our revenue producing employees a percentage of their earned revenue. Compensation and benefits is our largest expenditure and this variable compensation component represents a significant proportion of this expense. Compensation for our employees is derived as a percentage of our revenue regardless of the profitability of the Company. Therefore, we may continue to pay individual revenue producers a significant amount of cash compensation as the overall business experiences negative cash flows and/or net losses. We may not be able to recruit or retain revenue producing employees if we modify or eliminate the variable compensation component from our business model.

We may be dependent on a limited number of customers for a significant portion of our revenue.

During the nine months ended September 30, 2005, no single customer accounted for more than 10% of our revenue. However, we have been dependent on one customer, or on a small number of customers, for a large percentage of our revenue at some times in the past and we cannot assure you that we will not become so dependent again in the future. If we do become dependent on a single customer or small group of customers, the loss of one or more large customers could materially adversely affect our business and results of operations.

We may suffer losses through our investments in securities purchased in secondary market transactions or private placements.

Occasionally, our company, its officers and/or employees may make principal investments in securities through secondary market transactions or through direct investment in companies through private placements. In many cases, employees and officers with investment discretion on behalf of our company decide whether to invest in our company's account or their personal account. It is possible that gains from investing will accrue to these individuals because investments were made in their personal accounts, and our company will not realize gains because it did not make an investment. Conversely, it is possible that losses from investing will accrue to our company, while these individuals do not experience losses in their personal accounts because the individuals did not make investments in their personal accounts.

We may be unable to successfully integrate acquired businesses into our existing business and operations.

On February 28, 2005, the Company acquired Catalyst Financial Planning & Investment Management, Inc., a registered investment advisor with over \$100 million in assets under management. We may experience difficulty integrating the operations of Catalyst into our existing business and operations including our accounting, finance, compensation, information technology and management systems. We may not be able to retain the services of Catalyst employees. These factors could result in higher than anticipated costs associated with the Catalyst acquisition. Additionally, they may cause revenue from the Catalyst acquisition to be lower than forecast. If costs are higher or revenue lower than we expect, our business and results of operations could be materially adversely affected.

Although we have no specific plans to do so at this time, we may buy one or more other businesses in the future. If we are unable to successfully integrate such businesses into our existing business and operations in the future, our business and results of operations could be materially adversely affected

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We may be unable to effectively manage rapid growth that we may experience, which could place a continuous strain on our resources and, accordingly, adversely affect our business.

We plan to expand our operations. Our growth, if it occurs, will impose significant demands on our management, financial, technical and other resources. We must adapt to changing business conditions and improve existing systems or implement new systems for our financial and management controls, reporting systems and procedures and expand, train and manage a growing employee base in order to manage our future growth. We may not be able to implement improvements to our internal reporting systems in an efficient and timely manner and may discover deficiencies in existing systems and controls. We believe that future growth will require implementation of new and enhanced communications and information systems and training of our personnel to operate such systems. Furthermore, we may acquire existing companies or enter into strategic alliances with third parties, in order to achieve rapid growth. For us to succeed, we must make our existing business and systems work effectively with those of any strategic partners without undue expense, management distraction or other disruptions to our business. We may be unable to implement our business plan if we fail to manage any of the above growth challenges successfully. Our financial results may suffer and we could be materially and adversely affected if that occurs.

Our business and operations would suffer in the event of system failures.

Our success, in particular our ability to successfully facilitate securities brokerage transactions and provide high-quality customer service, largely depends on the efficient and uninterrupted operation of our computer and communications systems. Our systems and operations are vulnerable to damage or interruption from fire, flood, power loss, telecommunication failures, break-ins, earthquake and similar events. Despite the implementation of network security measures, redundant network systems and a disaster recovery plan, our servers are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions, which could lead to interruptions, delays, loss of data or the inability to accept and fulfill customer orders. Additionally, computer viruses may cause our systems to incur delays or other service interruptions, which may cause us to incur additional operating expenses to correct problems we may experience. Any of the foregoing problems could materially adversely affect our business or future results of operations.

We are highly dependent on proprietary and third-party systems; therefore, system failures could significantly disrupt our business.

Our business is highly dependent on communications and information systems, including systems provided by our clearing brokers. Any failure or interruption of our systems, the systems of our clearing broker or third party trading systems could cause delays or other problems in our securities trading activities, which could have a material adverse effect on our operating results.

In addition, our clearing brokers provide our principal disaster recovery system. We cannot assure you that we or our clearing brokers will not suffer any systems failure or interruption, including one caused by an earthquake, fire, other natural disaster, power or telecommunications failure, act of God, act of war or otherwise, or that our or our clearing brokers' back-up procedures and capabilities in the event of any such failure or interruption will be adequate.

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Our common stock price may be volatile, which could adversely affect the value of your shares.

The market price of our common stock has in the past been, and may in the future continue to be, volatile. A variety of events may cause the market price of our common stock to fluctuate significantly, including:

- variations in quarterly operating results;
- our announcements of significant contracts, milestones, acquisitions;
- our relationships with other companies;
- our ability to obtain needed capital commitments;
- additions or departures of key personnel;
- sales of common stock, conversion of securities convertible into common stock, exercise of options and warrants to purchase common stock or termination of stock transfer restrictions;
- general economic conditions, including conditions in the securities brokerage and investment banking markets;
- changes in financial estimates by securities analysts; and
- fluctuation in stock market price and volume.

Many of these factors are beyond our control. Any one of the factors noted herein could have an adverse effect on the value of our common stock.

In addition, the stock market in recent years has experienced significant price and volume fluctuations that have particularly affected the market prices of equity securities of many companies and that often have been unrelated to the operating performance of such companies. These market fluctuations have adversely impacted the price of our common stock in the past and may do so in the future.

Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk

Our risk management strategies and techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk.

We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure, breach of contract or other reasons. We are also subject to the risk that our rights against third parties may not be enforceable in all circumstances. As a clearing member firm, we finance our customer positions and could be held responsible for the defaults or misconduct of our customers. Although we regularly review credit exposures to specific clients and counterparties and to specific industries and regions that we believe may present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee. In addition, concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect us. If any of the variety of instruments, processes and strategies we utilize to manage our exposure to various types of risk are not effective, we may incur losses.

We could be sued in a securities class action lawsuit.

In the past, following periods of volatility in the market price of a company's securities, securities class action litigation often has been instituted against that company. Such litigation is expensive and diverts management's attention and resources. We can not assure you that we will not be subject to such litigation. If we are subject to such litigation, even if we ultimately prevail, our business and financial condition may be adversely affected.

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Your ability to sell your shares may be restricted because there is a limited trading market for our common stock.

Although our common stock is currently traded on the American Stock Exchange, an active trading market in our stock has been limited. Accordingly, you may not be able to sell your shares when you want or at the price you want.

Anti-takeover provisions of the Delaware General Corporation Law could discourage a merger or other type of corporate reorganization or a change in control even if it could be favorable to the interests of our stockholders.

The Delaware General Corporation Law contains provisions that may enable our management to retain control and resist our takeover. These provisions generally prevent us from engaging in a broad range of business combinations with an owner of 15% or more of our outstanding voting stock for a period of three years from the date that such person acquires his or her stock. Accordingly, these provisions could discourage or make more difficult a change in control or a merger or other type of corporate reorganization even if it could be favorable to the interests of our stockholders.

Because our Board of Directors can issue common stock without stockholder approval, you could experience substantial dilution.

Our Board of Directors has the authority to issue up to 300,000,000 shares of common stock and to issue options and warrants to purchase shares of our common stock without stockholder approval in certain circumstances. Future issuance of additional shares of our common stock could be at values substantially below the price at which you may purchase our stock and, therefore, could represent substantial dilution. In addition, our Board of Directors could issue large blocks of our common stock to fend off unwanted tender offers or hostile takeovers without further stockholder approval.

Our ability to issue additional preferred stock may adversely affect your rights as a common stockholder and could be used as an anti take-over device.

Our Articles of Incorporation authorize our Board of Directors to issue up to an additional 37,293,000 shares of preferred stock, without approval from our stockholders. If you hold our common stock, this means that our Board of Directors has the right, without your approval as a common stockholder, to fix the relative rights and preferences of the preferred stock. This would affect your rights as a common stockholder regarding, among other things, dividends and liquidation. We could also use the preferred stock to deter or delay a change in control of our Company that may be opposed by our management even if the transaction might be favorable to you as a common stockholder.

Our officers and directors exercise significant control over our affairs, which could result in their taking actions of which other stockholders do not approve.

Our executive officers and directors, and entities affiliated with them, currently control approximately 23% of our outstanding common stock including exercise of their options and warrants. These stockholders, if they act together, will be able to exercise substantial influence over all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions. This concentration of ownership may also have the effect of delaying or preventing a change in control of us and might affect the market price of our common stock.

Any exercise of outstanding stock options and warrants will dilute then-existing stockholders' percentage of ownership of our common stock.

We have a significant number of outstanding stock options and warrants. During the nine months ended September 30, 2005, shares issuable upon the exercise of these options and warrants, at prices ranging currently from

approximately \$0.18 to \$1.32 per share, represent approximately 16% of our total outstanding stock on a fully diluted basis using the treasury stock method.

The exercise of the outstanding options and warrants would dilute the then-existing stockholders' percentage ownership of our common stock. Any sales resulting from the exercise of options and warrants in the public market could adversely affect prevailing market prices for our common stock. Moreover, our ability to obtain additional equity capital could be adversely affected since the holders of outstanding options and warrants may exercise them at a time when we would also wish to enter the market to obtain capital on terms more favorable than those provided by such options and warrants. We lack control over the timing of any exercise or the number of shares issued or sold if exercises occur.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

The following discussion about market risk disclosures involves forward-looking statements. Actual results could differ materially from those projected in the forward-looking statements. We may be exposed to market risks related to changes in equity prices, interest rates and foreign currency exchange rates. We do not use derivative financial instruments for speculative, trading or any other purpose.

Equity Price Risk

The potential for changes in the market value of our trading positions is referred to as “market risk.” Our trading positions result from proprietary trading activities. Equity price risks result from exposures to changes in prices and volatilities of individual equities and equity indices. We seek to manage this risk exposure through diversification and limiting the size of individual positions within the portfolio. The effect on earnings and cash flows of an immediate 10% increase or decrease in equity prices generally is not ascertainable and could be positive or negative, depending on the positions we hold at the time. We do not establish hedges in related securities or derivatives.

Interest Rate Risk

Our exposure to market risk resulting from changes in interest rates relates primarily to our investment portfolio and long term debt obligations. Our interest income and cash flows may be impacted by changes in the general level of U.S. interest rates. We do not hedge this exposure because we believe that we are not subject to any material market risk exposure due to the short-term nature of our investments. We would not expect an immediate 10% increase or decrease in current interest rates to have a material effect on the fair market value of our investment portfolio.

Our long term debt obligations bear interest at a fixed rate. Accordingly, an immediate 10% increase or decrease in current interest rates would not have an impact on our interest expense or cash flows. The fair market value of our long term fixed interest rate debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. We would not expect an immediate 10% increase or decrease in current interest rates to have a material impact on the fair market value of our long term debt obligations.

Foreign Currency Risk

We do not have any foreign currency denominated assets or liabilities or purchase commitments and have not entered into any foreign currency contracts. Accordingly, we are not exposed to fluctuations in foreign currency exchange rates.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures - We have established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on their evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934), the Principal Executive Officer and Principal Financial Officer of the Company have concluded that the disclosure controls and procedures are effective as of September 30, 2005.

Changes in internal controls - There was no change in the Company's internal control over financial reporting (as defined in Rules 13a-15(d) and 15d-15(d) of the Exchange Act) that occurred during the three months ended September 30, 2005, that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Merriman Curhan Ford & Co. v. The Seidler Companies, Inc. — NASD Arbitration

During 2004, our broker-dealer subsidiary hired a research analyst. Prior to employment with Merriman Curhan Ford & Co. the analyst was employed by The Seidler Companies, Inc., or Seidler, in a similar capacity. The analyst was employed under an employment contract that included terms which general counsel and outside counsel believe unlawfully restrict the analyst's employment activities.

In March 2004, we acted as a co-agents for a small private placement for a client. The client was introduced to one of our investment banking managing directors. At the time of introduction, Seidler had been trying to win the investment banking business, but had failed to obtain a signed engagement letter with the client. We subsequently received a signed engagement letter from the client that named Merriman Curhan Ford & Co. as co-placement agent. The investment banking transaction was completed.

Thereafter, in March 2004 we received a cease and desist letter from attorneys representing Seidler. Seidler claims that our analyst used proprietary information in violation of his employment agreement when introducing Merriman Curhan Ford & Co. to the client. Seidler further claims that we used unfair business tactics to win the business. In response to the claims, Merriman Curhan Ford & Co. and our analyst filed a claim in arbitration with the NASD in June 2004.

In September 2005, this matter was settled. We received a release of all claims from Seidler in exchange for a payment in the amount of \$25,000.

Westerman v. Western Capital Financial Group - NASD Arbitration

In May 2005, our broker-dealer subsidiary Merriman Curhan Ford & Co. was served with a claim in NASD Arbitration by Ms. Westerman. The claim names Western Capital Financial Group as one of several defendants. Western Capital Financial Group is the predecessor name of Merriman Curhan Ford & Co., the California corporation. The Western Capital Financial Group name was effective from June 26, 1986 to July 14, 1998.

This claim arises from Ms. Westerman's purchase of a variable annuity product in January 1990 from a predecessor of our broker-dealer subsidiary. MCF Corporation acquired Merriman Curhan Ford & Co. in December 2001. The Claimant alleges that a registered representative improperly recommended that she move her investment to different products on two occasions.

Claimant alleges a theory of predecessor liability against Merriman Curhan Ford & Co. Claimant prays for monetary damages in excess of \$300,000 against the eleven named respondents. We do not believe that Ms. Westerman's claims against Merriman Curhan Ford & Co. are meritorious. We are in the early pleading stages of the matter and a hearing date has not been assigned. This matter was to be heard in New Orleans. Because of the flooding disaster, this matter will be delayed indefinitely. Based upon the facts as we know them to date, we do not believe that the outcome will have a material effect on the Company.

In re Odimo Incorporated Securities Litigation.

Merriman Curhan Ford & Co. is a defendant in an alleged class action suit brought in connection with a registered offering involving Odimo Incorporated in which we served as co-manager for the company. The complaint, filed in

the 17th Judicial Circuit Court for Broward County in Florida on September 30, 2005, alleges violations of federal securities laws against Odimo and certain of its officers as well as the company's underwriters, including us, based on alleged misstatements and omissions in the registration statement. We believe we have meritorious defenses to the actions and intend to vigorously defend against such claims as they apply to our firm. Based upon the facts as we know them to date, we do not believe that the outcome will have a material effect on the Company.

Additionally, from time to time, we are involved in ordinary routine litigation incidental to our business.

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Item 2. Recent Sales of Unregistered Securities

On May 4, 2005, MCF Corporation entered into a strategic alliance with Ascend Services Ltd., or Ascend. In conjunction with this alliance, Ascend has entered into a stock purchase agreement with the Company. Ascend has also engaged the Company as an investment advisor for its short-term high credit-quality portfolio. The Company issued 1,078,749 shares of its common stock and Ascend has issued an unsecured promissory note payable to the Company in the amount of \$1.5 million. The shares will be held initially in escrow. Upon Ascend achieving specified milestones, the 1,078,749 shares of common stock will be released from escrow in three installments of 359,583 shares and provided to Ascend. Upon satisfaction of the conditions specified in the escrow agreement and simultaneous with the release of the related stock certificates, the related amount of the promissory note shall become effective and start accruing interest. The promissory note accrues interest at 10% per annum and matures on February 28, 2006. The securities described in this paragraph: (i) were issued to a private investor without the involvement of underwriters; (ii) were issued in reliance on the exemption from registration requirements contained in Section 4(2) of the Securities Act of 1933; and (iii) carried certain registration rights.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

Current Report on Form 8-K dated August 9, 2005, reporting the announcement of earnings for the second quarter of 2005.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

MCF CORPORATION

November 9, 2005

By: /s/ D. JONATHAN MERRIMAN
D. Jonathan Merriman,
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

November 9, 2005

By: /s/ JOHN D. HIESTAND
John D. Hiestand
Chief Financial Officer
(Principal Financial Officer)