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VFINANCE INC
Form 10KSB/A
August 18, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB/A

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

Commission File Number 1-11454-03

VFINANCE, INC.

(f/k/a vFinance.com, Inc.)
(Name of Small Business Issuer in Its Charter)

Delaware

58-1974423

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

3010 North Military Trail, Suite 300
Boca Raton, FL 33431

(561) 981-1000

(Address of Principal Executive Offices)

(Issuer's Telephone Number,
Including Area Code)

Securities registered under Section 12(b) of the Act: NONE

Securities registered under Section 12(g) of the Act:

COMMON STOCK, PAR VALUE \$0.01 PER SHARE

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") during the past 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 [X] No []

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB. []

The issuer's revenues for the fiscal year ended December 31, 2001 were \$15,769,223.

The aggregate market value of the voting stock held by non-affiliates of the issuer on March 27, 2002, based upon the average bid and ask prices of such stock on that date was \$6,974,163. The number of shares of Common Stock of the issuer outstanding as of March 27, 2002 was 23,387,097.

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DOCUMENTS INCORPORATED BY REFERENCE : NONE

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FORWARD-LOOKING STATEMENTS

The following information provides cautionary statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Reform Act). We identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements we make in

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this report or in other documents that reference this report. All statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, identified through the use of words or phrases such as we or our management believes, expects, anticipates, hopes, words or phrases such as will result, are expected to, will continue, is anticipated, estimated, projection and outlook, and words of similar import) are not statements of historical facts and may be forward-looking. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties including, but not limited to, economic, competitive, regulatory, growth strategies, available financing and other factors discussed elsewhere in this report and in the documents filed by us with the Securities and Exchange Commission ("SEC"). Many of these factors are beyond our control. Actual results could differ materially from the forward-looking statements we make in this report or in other documents that reference this report. In light of these risks and uncertainties, there can be no assurance that the results anticipated in the forward-looking information contained in this report or other documents that reference this report will, in fact, occur.

These forward-looking statements involve estimates, assumptions and uncertainties, and, accordingly, actual results could differ materially from those expressed in the forward-looking statements. These uncertainties include, among others, the following: (i), the inability of our broker-dealer operations to operate profitably in the face of intense competition from larger full service and discount brokers; (ii) a general decrease in merger and acquisition activities and our potential inability to receive success fees as a result of transactions not being completed; (iii) increased competition from business development portals; (iv) technological changes; (v) our potential inability to implement our growth strategy through acquisitions or joint ventures; and (vi) our potential inability to secure additional debt or equity financing.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for our management to predict all of such factors, nor can our management assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

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PART I

ITEM 1. DESCRIPTION OF BUSINESS.

BUSINESS DEVELOPMENT

We are a holding company engaged in retail and institutional securities brokerage, investment banking and research services through our principal operating subsidiary, vFinance Investments, Inc. We are committed to establishing a significant presence in the financial services industry by meeting the varying investment needs of our corporate, institutional and individual clients.

OUR HISTORY. We were incorporated in the state of Delaware in February 1992 under the name Peachtree Fiberoptics, Inc., primarily to engage in the

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production and sale of plastic optical fiber. On October 27, 1993, we ceased all operations and subsequently sold certain assets relating to our machinery and optical fiber operations.

On November 8, 1999, we acquired vFinance Holdings, Inc., a Florida corporation, and Union Atlantic LC, a Florida limited liability company, through a Share Exchange Agreement. We received all the outstanding capital stock of vFinance Holdings, Inc. and all the outstanding membership interests of Union Atlantic LC in exchange for a total of 6,955,000 shares of our common stock. vFinance Holdings, Inc. has succeeded to the business of Union Atlantic LC and its operating subsidiary, Union Atlantic Capital, L.C., is now operating under the name vFinance Capital, Inc.

On January 4, 2001, we closed the merger of NW Holdings, Inc., a Florida corporation, with and into us with us as the surviving corporation. On the closing date of the merger, NW Holdings, Inc. was the parent company of and wholly owned First Level Capital, Inc., a Florida corporation. First Level Capital, Inc. is now known as vFinance Investments, Inc., an investment-banking firm that is licensed to conduct activities as a broker-dealer in 49 states and has offices in New York, New Jersey and Florida. vFinance Investments, Inc., our wholly owned subsidiary, continues to provide investment-banking services to small and medium sized companies and retail brokerage services to companies, financial institutions and individual investors.

On January 4, 2001, we also completed the merger of Colonial Direct Financial Group, Inc., a Delaware corporation, with and into Colonial Acquisition Corp., our wholly owned subsidiary, with Colonial Direct Financial Group, Inc. as the surviving corporation and as our wholly owned subsidiary. At the time of the merger, Colonial Direct Financial Group, Inc. was a holding company comprised of two diversified financial services companies, including First Colonial Securities Group, Inc. and Colonial Direct Retirement Services, Inc., and a company that provides administrative support to these financial service companies, Colonial Direct Capital Management, Inc. The Colonial group of companies is now inactive but some of its personnel were absorbed into vFinance Investments, Inc.

On August 20, 2001, we entered into a Securities Exchange Agreement by means of which we acquired the membership interests in two related companies, Critical Investments, LLC, a Delaware limited liability company ("Critical Investments"), and Critical Advisors, L.L.C., a Virginia limited liability company ("Critical Advisors"). Critical Investments manages Critical Infrastructure Fund, L.P. ("Critical Infrastructure LP"), a Delaware limited partnership. Critical Advisors manages Critical Infrastructure Fund, Ltd. ("Critical Infrastructure Ltd."), an international business company organized and existing under the laws of the British Virgin Islands and receives (i) a management fee equal to 1% of the net asset value of Critical Infrastructure Ltd. and (ii) a performance fee equal to 20% of the increase in net asset value of Critical Infrastructure Ltd. Critical Infrastructure LP and Critical Infrastructure Ltd. are the sole general partners in, owning 96% and 4%, respectively, and conduct their investment and trading activity through Critical Infrastructure Fund (BVI), LP, a limited partnership organized and existing under the laws of the British Virgin Islands, which holds a portfolio of securities. We are evaluating the continued management of the funds. Critical Investments and Critical Advisors changed their names to vFinance Investors, LLC and vFinance Advisors, LLC, respectively, subsequent to the acquisition.

OUR COMPANY. We are a "new breed" financial services enterprise committed to building a worldwide audience of individuals looking to create wealth through equity investments in both their personal portfolios and their businesses. Our website, www.vfinance.com, is one of the Internet's leading destinations for entrepreneurs, owners of small and medium sized businesses, private (i.e. Angel) and institutional investors looking for capital or equity investments in high

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growth companies. It allows entrepreneurs, executives, private and institutional investors, our brokerage clients and our employees to access a common portal filled with business development - tools, information and investment management products. Each month our website attracts an estimated 100,000 businesses from over 75 countries and communicates to approximately 60,000 high net worth individuals and institutional investors. Utilizing the Internet and other traditional communication mediums, we generate income by providing our audience with access to products and services that assist them in achieving their financial goals. Our business model is scalable as the website provides sales leads to our "bricks and mortar" businesses in the areas of investment banking, management consulting, brokerage, trading and asset management.

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Our strategy is to continue to build the website into one of the world's leading business development portals and thereby be positioned as a premier new media enterprise leveraging the convergence of digital information with the other traditional communication mediums to build a global brand that in turn generates leads for other vFinance activities. Our website is typically listed by search engines as one of the top ten sites for relevant content. In addition, over 3000 websites have links to our website including Microsoft Network, Dow Jones, THE WALL STREET JOURNAL, ENTREPRENEUR MAGAZINE, INC. MAGAZINE, Stanford University, and SNAP. The combination of relevant content and ease of use has resulted in our website servicing over 100,000 user sessions and 1,200,000 page views each month with the average user session length in excess of fifteen minutes.

RECENT FINANCINGS

We recently entered into two agreements with financial institutions to allow us to better utilize our resources. The discussion below is qualified in its entirety by reference to the copies of the agreements attached as exhibits to this report.

On November 28, 2001, we entered into a Note Purchase Agreement, as amended by letter agreements dated November 30, December 14 and December 28, 2001, February 13, 2002 and March 4, 2002 (collectively, the "Agreement"), with SBI Investments (USA) Inc. ("SBI"). Under the terms of the Agreement, SBI provided a loan to us in the amount of \$975,000 in the form of a 48-month non-interest bearing, convertible note and may provide an additional loan to us in the amount of \$525,000 by no later than June 30, 2002. The note, if fully funded by SBI, is convertible at SBI's option into 5,263,158 shares of our common stock at \$0.285 per share. If SBI funds the full amount of the loan, SBI will become a party to an Investor Right Agreement and, as additional consideration we will issue to SBI an option to purchase up to that number of shares of our common stock equal to 1,500,000 divided by the average closing bid and ask price of our common stock for the 20 consecutive trading days preceding the date of SBI's exercise notice to us, but in no event will the number be more than .336 or less than .23. The option may be exercised from time to time until June 30, 2002. At that time, we will evaluate the embedded beneficial conversion feature present in these convertible securities and make provision for those non-cash expenses if any.

On January 25, 2002, we entered into a Credit Agreement, as amended on April 12, 2002, with UBS Americas, Inc. ("UBS"). Under the terms of the Credit Agreement, UBS provided a revolving credit facility for up to \$3,000,000 to us for the purpose of supporting the expansion of our brokerage business or investments in

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infrastructure to expand our operations or our broker-dealer operations. The loan must be repaid in full by January 2005 and bears interest at LIBOR plus a LIBOR margin of 2%. Among other covenants, we must maintain stockholders' equity of at least \$7 million; however, the Credit Agreement, as amended, provides that we may exclude goodwill write-offs aggregating \$8.5 million from stockholders' equity. We must make early repayments under the Credit Agreement if we acquire a new broker dealer firm, enter a new line of business, or hire more than four brokers in a single or related transactions. This repayment will be made by adding \$1.00 to the cost of each incremental closing transaction we make through CSC, an affiliate of UBS.

We borrowed \$1,500,000 under the credit facility in January 2002. The amount of the loan under the credit facility is not convertible into our equity securities.

OUR BUSINESS

RETAIL BUSINESS. The largest portion of our revenues in 2001 (73% in 2001) (0% in 2000) were attributable to commissions generated by our brokerage activities through our wholly owned broker-dealer subsidiary, vFinance Investments. vFinance Investments buys and sells securities for its customers from other dealers on an agency basis, and charges its customers a commission for its services. Such commission revenue is derived from brokerage transactions in listed and over-the-counter securities and mutual fund securities. vFinance Investments has agreements with numerous mutual fund management companies pursuant to which it sells shares in a variety of mutual funds. Mutual fund commissions are derived from standard dealers' discounts that are a small percentage of the purchase price of the shares depending upon the terms of the dealer agreement and the size of the transaction. In addition, most funds permit vFinance Investments to receive additional periodic fees based upon the customer's investment maintained in particular funds.

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INVESTMENT BANKING AND MERGERS AND ACQUISITIONS. A significant portion of our revenues in our last fiscal year were derived from the success fees generated by the investment-banking and the merger and acquisition activities (16% in 2001) (54% in 2000) of the vFinance Capital division of vFinance Investments, Inc. Through vFinance Capital, we offer capital raising and related services to (A) emerging growth and middle market privately held companies worldwide by assisting such companies in (i) developing sound strategic plans, (ii) obtaining growth, mezzanine, bridge, or acquisition capital (including, but not limited to, venture capital financing), (iii) pursuing strategically sound acquisitions or divestiture strategies, (iv) transitioning into viable professional corporations able to raise funds in the public markets, and (v) maximizing shareholder value by conducting recapitalizations or other liquidity transactions and (B) publicly held companies by arranging private equity financing for such publicly held companies. As consideration for such services, we are paid success fees which are agreed upon amounts based on the percentage of the total value of a transaction and are contingent on the successful completion of a specified transaction. As part of our success fees, we periodically receive equity instruments and stock purchase warrants from companies for which we perform services in addition to the cash paid for such services. Primarily all of the equity instruments are in private companies or small public companies. During our last fiscal year, the investment-banking and merger and acquisition activities of vFinance Capital consisted of acting as a

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placement agent for fourteen private placements, as an agent for one merger and as a consultant for two public companies.

Since 1996, the principals of vFinance Capital and its predecessor, Union Atlantic Capital, L.C., have structured private equity and debt placements totaling in excess of \$300 million. The great majority of these financings are for companies with market capitalizations between \$10 and \$150 million.

In the corporate finance area, our subsidiaries have been active as underwriters or selling group members in numerous public equity transactions. Participation as a managing underwriter or in an underwriting syndicate involves both economic and regulatory risks. An underwriter may incur losses if it is unable to resell the securities it is committed to purchase. In addition, under the federal securities laws, other laws and court decisions with respect to underwriters' liabilities and limitations on the indemnification of underwriters by issuers, an underwriter is subject to substantial potential liability for misstatements or omissions of material facts in prospectuses and other communications with respect to such offerings. Acting as a managing underwriter increases these risks. Underwriting commitments constitute a charge against net capital and our subsidiaries' ability to make underwriting commitments may be limited by the requirement that they must at all times be in compliance with regulations regarding their net capital.

MANAGEMENT CONSULTING. A portion of our revenues in our last fiscal year were derived from consulting fees generated by the management consulting activities of vFinance Holdings (5% in 2001 and 40% in 2000). Through vFinance Holdings we provide management consulting services and related services to corporations and high net worth individuals by working with the senior management of those corporations and high net worth individuals to (i) assess market conditions and evaluate their assets (tangible and intangible) and their operational capabilities; (ii) identify alternative strategies, establish processes to build consensus and create strategies for effectively implementing changes; and (iii) prepare a report formalizing our findings that serves as a tactical tool to ensure communication and consistency in planning and coordination of efforts. In addition, through the executive search practice of vFinance Holdings, we assist companies in identifying and recruiting talented individuals to help the companies grow. vFinance Holdings specializes in senior executive and board member searches for public companies as well as venture backed and private equity companies. As consideration for these services, vFinance Holdings is paid consulting fees that are based on a monthly retainer. As part of its consulting fees, vFinance Holdings periodically receives equity instruments and warrants from companies for which it performs services in addition to the cash paid for such services.

MARKET-MAKING BUSINESS. In support of both of the firm's retail brokerage and investment banking businesses, we offer our retail brokerage, corporate and financial institutions wholesale market-making services. vFinance Investments makes markets in over 900 Over-the-Counter Bulletin Board and NASDAQ Small Cap stocks. We offer our clients professional execution of trades. This expertise supports the firm's investment banking strategy of servicing high growth public companies that are looking for a financial services firm that is capable of assisting them in building broad based market support for their securities. Market makers use the firm's own capital, research, retail and/or systems resources to represent a stock and compete with each other market makers to buy and sell the stocks or issues they represent. Operated primarily by electronic execution, buyers and sellers meet via computer to make bids and offers. Each market maker competes for "customer order flow" by displaying buy and sell quotations for a guaranteed number of shares in a security. Once an order is received, the market maker will immediately purchase for or sell from its own inventory, or seek the other side of the trade until it is executed, often in a matter of seconds. The market maker generates all of its revenue from the difference between the price paid when a security is bought and price received

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when that security is sold or the price received when the security is shorted and the price received when the short is covered. The Company's target customers are national and regional full-service broker-dealers, electronic discount brokers and institutional investors that require fast and efficient executions for each security.

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INTERNET STRATEGY (WWW.VFINANCE.COM). Through vFinance Holdings, Inc., we operate a branded investment-banking channel on the Web located at www.vfinance.com, offering visitors to our website convenient access to a variety of financial services, proprietary business development tools, searchable databases and daily news. We target a worldwide audience of entrepreneurs, CEOs, private investors and investment firms, allowing them to interconnect, transact and grow wealth. Our Venture Capital Resource Library of information on the website offers current articles on venture capital and other issues, information on initial public offerings, a searchable database of investment opportunities, and links to EDGAR, the SEC's database of electronic filings by public companies. Our website also provides directory listings for venture capital firms, investment banks, lenders, so-called venture capital angels (which provide first round financing for risky investments), accountants, financial printers, public relations firms, transfer agents and other types of companies providing business services. In addition, we offer through our website to start-ups and other early-stage firms a Web-based search engine, vSearch, of our proprietary database of venture capital firms by different criteria, including geography, amount of funds required, industry, stage of corporate development or keyword. Furthermore, we opened an online loan center on our website where growing businesses can apply for loans of up to \$20 million. Most of the website provides information to the small business executive or entrepreneur free of charge. However, we do charge nominal fees for the use of proprietary search engines and premium services such as financial service listings and business plan listings.

RESEARCH SERVICES. Our research departments focus on investigating investment opportunities by utilizing fundamental, technical and quantitative methods to conduct in-depth analysis. Our research departments:

- review and analyze general market conditions and other industry groups;
- issue written reports on companies, with recommendations on specific actions to buy, sell or hold;
- furnish information to retail and institutional customers; and
- respond to inquiries from customers and account executives.

Additionally, our research analysts interface regularly with industry leaders and portfolio managers in order to produce actionable evaluations and decisions. These recommendations are communicated to clients and the firm via company and industry reports.

ADMINISTRATION, OPERATIONS, SECURITIES TRANSACTIONS PROCESSING AND CUSTOMER ACCOUNTS

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Our operating subsidiaries do not hold any funds or securities for their customers. Instead, they use the services of clearing agents on a fully disclosed basis. These clearing agents process all securities transactions and maintain customer accounts on a fee basis. Customer accounts are protected through the SIPC for up to \$500,000, of which coverage for cash balances is limited to \$100,000. In addition, all customer accounts are fully protected by an Excess Securities Bond providing protection for the account's entire net equity (both cash and securities). The services of our subsidiaries' clearing agents include billing, credit control, and receipt, custody and delivery of securities. The clearing agents provide operational support necessary to process, record, and maintain securities transactions for each of our subsidiaries' brokerage activities. They provide these services to our subsidiaries' customers at a total cost which we believe is less than it would cost us to process such transactions on our own. The clearing agents also lend funds to our subsidiaries' customers through the use of margin credit. These loans are made to customers on a secured basis, with the clearing agents maintaining collateral in the form of saleable securities, cash or cash equivalents. vFinance Investments, Inc. has agreed to indemnify the clearing brokers for losses they incur on these credit arrangements.

COMPETITION

Our subsidiaries encounter intense competition in all aspects of their business and compete directly with many other securities firms for clients, as well as registered representatives. Many of their competitors have significantly greater financial, technical, marketing and other resources than they do. National retail firms such as Merrill Lynch Pierce Fenner & Smith Incorporated, Salomon Smith Barney, Inc. and Morgan Stanley/Dean Witter dominate the industry. Our subsidiaries also compete with numerous regional and local firms. In addition, a number of firms offer discount brokerage services to retail customers and generally effect transactions at substantially lower commission rates on an "execution only" basis, without offering other services such as investment recommendations and research. Moreover, there is substantial commission discounting by full-service broker-dealers competing for institutional and retail brokerage business. The recent emergence of online trading has further intensified the competition for brokerage customers. Our subsidiaries currently do not offer any online trading services to their customers. The continued expansion of discount brokerage firms and online trading could adversely effect the retail business. Other financial institutions, notably commercial banks and savings and loan associations, offer customers some of the same services and products presently provided by securities firms. While it is not possible to predict the type and extent of competing services which banks and other institutions ultimately may offer to customers, our subsidiaries may be adversely affected to the extent those services are offered on a large scale basis. We try to compete through our advertising and recruiting programs for registered representatives interested in potentially joining our Company.

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GOVERNMENT REGULATION

REGULATION OF THE SECURITIES INDUSTRY AND BROKER-DEALERS. Our business is subject to extensive regulation applicable to the securities industry in the United States and elsewhere. As a matter of public policy, regulatory bodies in the United States and rest of the world are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. In the United States, the

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SEC is the federal agency responsible for the administration of the federal securities laws. In general, broker-dealers are required to register with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Under the Exchange Act, every registered broker-dealer that does business with the public is required to be a member of and is subject to the rules of the NASD. The NASD administers qualification testing for all securities principals and registered representatives for its own account and on behalf of the state securities authorities. VFinance Investments is a broker-dealer registered with the SEC and is a member of the NASD. Our broker-dealer is also subject to regulation under state law. vFinance Investments is currently registered as a broker-dealer in all 50 states and the District of Columbia. The NASD approved the change of ownership to us of (i) Union Atlantic Capital, L.C. from Pinnacle Capital Group, L.C., (ii) First Level Capital, Inc. from NW Holdings, Inc. and (iii) First Colonial Securities Group, Inc. A recent amendment to the federal securities laws prohibits the states from imposing substantive requirements on broker-dealers that exceed those imposed under federal law. The amendment, however, does not preclude the states from imposing registration requirements on broker-dealers that operate within their jurisdiction or from sanctioning these broker-dealers who have engaged in misconduct.

The SEC, self-regulatory organizations such as the NASD and state securities commissions may conduct administrative proceedings which can result in censure, fine, the issuance of cease-and-desist orders, or the suspension or expulsion of a broker-dealer, its officers, or its employees. The SEC and self-regulatory organization rules cover many aspects of a broker-dealer's business, including capital structure and withdrawals, sales methods, trade practices among broker-dealers, use, and safekeeping of customers' funds and securities, record-keeping, the financing of customers' purchases, broker-dealer and employee registration, and the conduct of directors, officers, and employees. Additional legislation, changes in rules promulgated by the Commission and self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules, may directly affect the mode of operation and profitability of broker-dealers.

The Uniform Net Capital Rule and NASD rules require prior notice to the SEC and the NASD for certain withdrawals of capital and also provide that the SEC may restrict for up to 20 business days any withdrawal of equity capital, or unsecured loans or advances to shareholders, employees or affiliates if the capital withdrawal, together with all other net capital withdrawals during a 30-day period, exceeds 30% of excess net capital and the SEC concludes that the capital withdrawal may be detrimental to the financial integrity of the broker-dealer.

In addition, the Uniform Net Capital Rule provides that the total outstanding principal amount of a broker-dealer's indebtedness under certain subordination agreements, the proceeds of which are included in its net capital, may not exceed 70% of the sum of the outstanding principal amount of all subordinated indebtedness included in net capital, par or stated value of capital stock, paid in capital in excess of par, retained earnings and other capital accounts for a period in excess of 90 days. A change in the Uniform Net Capital Rule, the imposition of new rules or any unusually large charge against net capital could limit those parts of our operations that require the intensive use of capital and also could restrict our ability to pay dividends, repay debt and repurchase shares of our outstanding stock.

As of December 31, 2001, the minimum amount of net capital required to be maintained by vFinance Investments was \$100,000. A significant operating loss or any unusually large charge against net capital could adversely affect our ability to expand or even maintain our present levels of business, which could harm our business. vFinance Investments is a member of Securities Investor Protection Corporation ("SIPC") which provides, in the event of the liquidation of a broker-dealer, protection for clients' accounts up to \$500,000, subject to

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a limitation of \$100,000 for claims for cash balances. Our clients' accounts are carried on the books and records of CSC. CSC has obtained additional insurance from a private insurer in an amount equal to \$4,500,000 for the benefit of our clients' accounts with vFinance Investments that is supplemental to SIPC protection.

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APPLICATION OF LAWS AND RULES TO INTERNET BUSINESS AND OTHER ONLINE SERVICES. Due to the increasing popularity and use of the Internet and other online services, various regulatory authorities are considering laws and/or regulations with respect to the Internet or other online services covering issues such as user privacy, pricing, content copyrights, and quality of services. In addition, the growth and development of the market for online commerce may prompt more stringent consumer protection laws that may impose additional burdens on those companies conducting business online. When the Securities Act of 1933, as amended (the "Securities Act"), which governs the offer and sale of securities, and the Exchange Act, which governs, among other things, the operation of the securities markets and broker-dealers, were enacted, such acts did not contemplate the conduct of a securities business through the Internet and other online services. The recent increase in the number of complaints by online traders could lead to more stringent regulations of online trading firms and their practices by the SEC, NASD and other regulatory agencies. Although the SEC, in releases and no-action letters, has provided guidance on various issues related to the offer and sale of securities and the conduct of a securities business through the Internet, the application of the laws to the conduct of a securities business through the Internet continues to evolve. Furthermore, the applicability to the Internet and other online services of existing laws in various jurisdictions governing issues such as property ownership, sales and other taxes and personal privacy is uncertain and may take years to resolve. Uncertainty regarding these issues may adversely affect the viability and profitability of our business.

As our services, through our subsidiaries, are available over the Internet in multiple jurisdictions, and as we, through our subsidiaries, have numerous clients residing in these jurisdictions, these jurisdictions may claim that our subsidiaries are required to qualify to do business as a foreign corporation in each such jurisdiction. While vFinance Investments is currently registered as a broker-dealer in the jurisdictions described in this report, vFinance Investments and our non-broker dealer subsidiaries are qualified to do business as a foreign corporation in only a few jurisdictions; failure to qualify as an out-of-state or foreign corporation in a jurisdiction where it is required to do so could subject us to taxes and penalties for the failure to qualify.

INTELLECTUAL PROPERTY

We own the following federally registered marks: vFinance.com, Inc.(R), AngelSearch(R)and First Colonial Securities Group, Inc.(R)In addition, we use the following trademarks: Union Atlantic LCTM, Union Atlantic Capital, L.C. TM, Colonial Direct Financial Group, Inc. TM, Colonial Direct Retirement Services, Inc. TM and Colonial Direct Capital Management, Inc. TM We believe the Colonial marks now have no value.

EMPLOYEES

At December 31, 2001, we employed the following personnel:

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Position	Salaried	Contract	Total
-----	-----	-----	-----
Officers	5	0	5
Clerical	35	0	35
Brokers	31	21	52
Traders	13	0	13
Investment Bankers	11	1	12
Website	4	0	4
Other	2	3	5
Totals			

None of our personnel is covered by a collective bargaining agreement. We consider our relationships with our employees to be good. Any future increase in the number of employees will depend upon the growth of our business. Our registered representatives are required to take examinations administered by the NASD and state authorities in order to qualify to transact business and are required to enter into agreements with us obligating them, among other things, to adhere to industry rules and regulations, our supervisory procedures and not to solicit customers in the event of termination of employment.

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RESEARCH AND DEVELOPMENT AND ENVIRONMENTAL MATTERS

We did not incur any research and development expenses. We do not incur any significant costs or experience any significant effects as a result of compliance with federal, state and local environmental laws.

RISKS RELATED TO OUR COMPANY

WE HAVE A LIMITED OPERATING HISTORY. AS A RESULT, YOU MAY HAVE DIFFICULTY EVALUATING OUR BUSINESS AND PROSPECTS.

We have a limited operating history. We only commenced our broker-dealer operations in the middle of 2000. In addition, we completely restructured our broker-dealer operations in 2001 through the acquisition of the two firms mentioned above and their merger into a single operation. We purchased our hedge fund management business in mid-2001 but have determined to liquidate such operation. Our website has been in existence since 1995. Our business and prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in the early stages of development. These risks are particularly severe among companies in new and rapidly evolving markets such as online business development services and those in regulated industries such as the securities industry. It may be difficult or impossible to accurately forecast our operating results and evaluate our business and prospects based on our historical results.

WE HAVE HAD SUBSTANTIAL AND CONTINUING LOSSES SINCE INCEPTION

Since inception, we have sustained substantial losses. Although we showed a profit for the quarter ending September 30, 2002, such losses continued through June 30, 2002 due to ongoing operating expenses and a lack of revenues sufficient to offset operating expenses. We have raised capital to fund ongoing operations by private sales of our securities, some of which sales have been

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highly dilutive and involve considerable expense.

We incurred net losses of \$17,453,860 and \$3,911,649 for the years ending December 31, 2001 and December 31, 2000 respectively. As of December 31, 2001, we had an accumulated deficit of \$21,254,359.

We expect to spend significant amounts to enhance our products and technologies, and to expand domestic and international sales and operations. As a result, we will need to generate significant additional revenue to achieve profitability based on such planned expenditures and expansion. Even if we do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. If we do not achieve and maintain profitability, the market price for our common stock may further decline, perhaps substantially.

If we do not receive additional capital when and in the amounts needed in the near future, our ability to continue as a going concern is in substantial doubt.

Obtaining future financing may be costly and will likely be dilutive to existing stockholders. If we are not able to obtain financing when and in the amounts needed, and on terms that are acceptable, our operations, financial condition and prospects could be materially and adversely affected, and we could be forced to curtail our operations or sell part or all of our assets.

WE WILL NEED TO RAISE ADDITIONAL FUNDS. THESE FUNDS MAY NOT BE AVAILABLE WHEN WE NEED THEM.

Based on our current plans and the funding noted above, we believe that our cash on hand and cash generated from our operations will be sufficient to fund our operations for at least the next 12 months. However, the Company may look to raise additional capital to operate the business, support expansion plans, develop new or enhanced services and products, respond to competitive pressures, acquire complementary businesses or technologies or respond to unanticipated events. We can provide no assurances that additional financing will be available when needed on favorable terms, or at all. If these funds are not available when we need them, we may need to change our business strategy or reduce our operations or investment activities. In addition, any issuance of additional equity securities will dilute the ownership interest of our existing stockholders and the issuance of additional debt securities may increase the perceived risk of investing in us.

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WE ARE SUBJECT TO VARIOUS RISKS ASSOCIATED WITH THE SECURITIES INDUSTRY.

As securities broker-dealers, we are subject to uncertainties that are common in the securities industry. These uncertainties include:

- the volatility of domestic and international financial, bond and stock markets, as demonstrated by recent disruptions in the financial markets;
- extensive governmental regulation;
- litigation;
- intense competition;
- substantial fluctuations in the volume and price level of securities; and
- dependence on the solvency of various third parties.

As a result, revenues and earnings may vary significantly from quarter to

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quarter and from year to year. In periods of low volume, profitability is impaired because certain expenses remain relatively fixed. We are much smaller and have much less capital than many competitors in the securities industry. In the event of a market downturn, our business could be adversely affected in many ways, including those described below. Our revenues are likely to decline in such circumstances and, if we are unable to reduce expenses at the same pace, our profit margins would erode.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY A BREAKDOWN IN THE FINANCIAL MARKETS.

As a securities broker-dealer, our business is materially affected by conditions in the financial markets and economic conditions generally, both in the United States and elsewhere around the world. Many factors or events could lead to a breakdown in the financial markets including war, terrorism, natural catastrophes and other types of disasters. These types of events could cause people to begin to lose confidence in the financial markets and their ability to function effectively. If the financial markets are unable to effectively prepare for these types of events and ease public concern over their ability to function, our revenues are likely to decline and our operations will be adversely affected.

WE HAVE INCURRED, AND MAY IN THE FUTURE INCUR, SIGNIFICANT LOSSES FROM TRADING AND INVESTMENT ACTIVITIES DUE TO MARKET FLUCTUATIONS AND VOLATILITY.

We generally maintain trading and investment positions in the equity markets. To the extent that we own assets, i.e., have long positions, in those markets, a downturn in those markets could result in losses from a decline in the value of those long positions. Conversely, to the extent that we have sold assets that we do not own, i.e., have short positions, in any of those markets, an upturn in those markets could expose us to potentially unlimited losses as we attempt to cover our short positions by acquiring assets in a rising market.

We may from time to time have a trading strategy consisting of holding a long position in one asset and a short position in another from which we expect to earn revenues based on changes in the relative value of the two assets. If, however, the relative value of the two assets changes in a direction or manner that we did not anticipate or against which we are not hedged, we might realize a loss in those paired positions. In addition, we maintain trading positions that can be adversely affected by the level of volatility in the financial markets, i.e., the degree to which trading prices fluctuate over a particular period, in a particular market, regardless of market levels.

OUR REVENUES MAY DECLINE IN ADVERSE MARKET OR ECONOMIC CONDITIONS.

Unfavorable financial or economic conditions may reduce the number and size of the transactions in which we provide underwriting services, merger and acquisition consulting and other services. Our investment banking revenues, in the form of financial advisory and underwriting fees, are directly related to the number and size of the transactions in which we participate and would therefore be adversely affected by a sustained market downturn. Additionally, a downturn in market conditions could lead to a decline in the volume of transactions that we execute for our customers and, therefore, to a decline in the revenues we receive from commissions and spreads.

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OUR RISK MANAGEMENT POLICIES AND PROCEDURES MAY LEAVE US EXPOSED TO UNIDENTIFIED RISKS OR AN UNANTICIPATED LEVEL OF RISK.

The policies and procedures we employ to identify, monitor and manage risks may not be fully effective. Some methods of risk management are based on the use of observed historical market behavior. As a result, these methods may not predict future risk exposures, which could be significantly greater than the historical measures indicate. Other risk management methods depend on evaluation of information regarding markets, clients or other matters that are publicly available or otherwise accessible by us. This information may not be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risk requires, among other things, policies and procedures to properly record and verify a large number of transactions and events. We cannot assure you that our policies and procedures will effectively and accurately record and verify this information.

We seek to monitor and control our risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems. We believe that we effectively evaluate and manage the market, credit and other risks to which we are exposed. Nonetheless, the effectiveness of our ability to manage risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have a material adverse effect on our results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in earnings, increases in our credit risk to customers as well as to third parties and increases in general systemic risk.

CREDIT RISK EXPOSES US TO LOSSES CAUSED BY FINANCIAL OR OTHER PROBLEMS EXPERIENCED BY THIRD PARTIES.

We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties include:

- trading counterparties;
- customers;
- clearing agents;
- exchanges;
- clearing houses; and
- other financial intermediaries as well as issuers whose securities we hold.

These parties may default on their obligations owed to us due to bankruptcy, lack of liquidity, operational failure or other reasons. This risk may arise, for example, from:

- holding securities of third parties;
- executing securities trades that fail to settle at the required time due to non-delivery by the counterparty or systems failure by clearing agents, exchanges, clearing houses or other financial intermediaries; and
- extending credit to clients through bridge or margin loans or other arrangements.

Significant failures by third parties to perform their obligations owed to us could adversely affect our revenues and perhaps our ability to borrow in the credit markets.

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WE MAY HAVE DIFFICULTY EFFECTIVELY MANAGING OUR GROWTH.

Over the past several years, we have experienced significant growth in our business activities and the number of our employees through a variety of transactions. We expect our business to continue to grow. Growth of this nature involves numerous risks such as:

- difficulties and expenses incurred in connection with the subsequent assimilation of the operations and services or products of the acquired company;
- the potential loss of key employees of the acquired company; and
- the diversion of management's attention from other business concerns.

If we are unable to effectively address these risks, we may be required to restructure the acquired business or write off the value of some or all of the assets of the acquired business. Further, this type of growth requires increased investments in management personnel, financial and management systems and controls, and facilities. We cannot assure you that we will experience parallel growth in these areas. If these areas do not grow at the same time, our operating margins may decline from current levels.

Additionally, as is common in the securities industry, we will continue to be highly dependent on the effective and reliable operation of our communications and information systems. We believe that our current and anticipated future growth will require implementation of new and enhanced communications and information systems and training of our personnel to operate such systems. Any difficulty or significant delay in the implementation or operation of existing or new systems or the training of personnel could adversely affect our ability to manage our growth.

INTENSE COMPETITION FROM EXISTING AND NEW ENTITIES MAY ADVERSELY AFFECT OUR REVENUES AND PROFITABILITY.

The securities industry is rapidly evolving, intensely competitive and has few barriers to entry. We expect competition to continue and intensify in the future. Many of our competitors have significantly greater financial, technical, marketing and other resources than we do. Some of our competitors also offer a wider range of services and financial products than we do and have greater name recognition and a larger client base. These competitors may be able to respond more quickly to new or changing opportunities, technologies and client requirements. They may also be able to undertake more extensive promotional activities, offer more attractive terms to clients, and adopt more aggressive pricing policies. We may not be able to compete effectively with current or future competitors and competitive pressures faced by us may harm our business.

THE PRECAUTIONS WE TAKE TO PREVENT AND DETECT EMPLOYEE MISCONDUCT MAY NOT BE EFFECTIVE AND WE COULD BE EXPOSED TO UNKNOWN AND UNMANAGED RISKS OR LOSSES.

We run the risk that employee misconduct could occur. Misconduct by employees could include:

- employees binding us to transactions that exceed authorized limits or present unacceptable risks to us;
- employees hiding unauthorized or unsuccessful activities from us; or
- the improper use of confidential information.

These types of misconduct could result in unknown and unmanaged risks or losses to us including regulatory sanctions and serious harm to our reputation. The precautions we take to prevent and detect these activities may not be effective. If employee misconduct does occur, our business operations could be materially adversely affected.

RISK OF LOSSES ASSOCIATED WITH SECURITIES LAWS VIOLATIONS AND LITIGATION.

Many aspects of our business involve substantial risks of liability. An underwriter is exposed to substantial liability under federal and state securities laws, other federal and state laws, and court decisions, including decisions with respect to underwriters' liability and limitations on indemnification of underwriters by issuers. For example, a firm that acts as an underwriter may be held liable for material misstatements or omissions of fact in a prospectus used in connection with the securities being offered or for statements made by its securities analysts or other personnel. In recent years, there has been an increasing incidence of litigation involving the securities industry, including class actions that seek substantial damages. Our underwriting activities will usually involve offerings of the securities of smaller companies, which often involve a higher degree of risk and are more volatile than the securities of more established companies. In comparison with more established companies, smaller companies are also more likely to be the subject of securities class actions, to carry directors and officers liability insurance policies with lower limits or not at all, and to become insolvent. Each of these factors increases the likelihood that an underwriter of a smaller company's securities will be required to contribute to an adverse judgment or settlement of a securities lawsuit.

In the normal course of business, our operating subsidiaries have been and continue to be the subject of numerous civil actions and arbitrations arising out of customer complaints relating to our activities as a broker-dealer, as an employer and as a result of other business activities. In general, the cases involve various allegations that our employees had mishandled customer accounts. We believe that, based on our historical experience and the reserves established by us, the resolution of the claims presently pending will not have a material adverse effect on our financial condition. However, although we typically reserve an amount we believe will be sufficient to cover any damages assessed against us, we have in the past been assessed damages that exceeded our reserves. If we misjudged the amount of damages that may be assessed against us from pending or threatened claims, or if we are unable to adequately estimate the amount of damages that will be assessed against us from claims that arise in the future and reserve accordingly, our financial condition may be materially adversely affected.

OUR DIRECTORS AND EXECUTIVE OFFICERS CONTROL APPROXIMATELY 34% OF OUR COMMON STOCK AND MAY HAVE INTERESTS DIFFERING FROM THOSE OF OTHER STOCKHOLDERS.

At December 31, 2001, our directors and executive officers control approximately 34% of our outstanding common stock, directly as stockholders and indirectly through control relationships with other stockholders. There is no supermajority vote. These directors and executive officers, if acting together, would be able significantly to influence all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions, including mergers, consolidations and the sale of substantially all of our assets. This control could have the effect of delaying or preventing a third party from acquiring or merging with us, which could hinder shareholder's ability to receive a premium for their shares.

OUR VFINANCE BRAND MAY NOT ACHIEVE THE BROAD RECOGNITION NECESSARY TO SUCCEED.

We believe that broader recognition and positive perception of the "vFinance" brand is essential to our future success. Accordingly, we intend to continue to

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pursue an aggressive brand enhancement strategy, which will include multimedia advertising, promotional programs and public relations activities. These initiatives will require significant expenditures. If our brand enhancement strategy is unsuccessful, these expenses may never be recovered and we may be unable to increase future revenues. Successful positioning of our brand will depend in large part on:

- o The success of our advertising and promotional efforts;
- o An increase in the number of users and page views of our website; and
- o The ability to continue to provide a website and services useful to our clients.

These expenditures may not result in sufficient increases in revenues to offset these expenditures. In addition, even if brand recognition increases, the number of new users or the number of page views of our website may not increase. Even if the number of new users increases, those users may not regularly use our website.

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FAILURE TO MAINTAIN OR INCREASE THE FLOW OF TRAFFIC TO OUR WEBSITE COULD HARM OUR BUSINESS.

Our business partially depends on our ability to maintain or increase traffic on our website as well as our ability to have visitors to our website use our services. The website is dependent on the flow of information for its validity. It is important for our business development activities to increase the number of daily visitors, repeat visitors and the amount of time visitors spend on our website. Failure to do so could adversely affect our revenue and our ability to raise additional funds.

IF WE DO NOT CONTINUE TO DEVELOP AND ENHANCE OUR SERVICES IN A TIMELY MANNER, OUR BUSINESS MAY BE HARMED.

Our future success will depend on our ability to develop and enhance our services and add new services. We operate in a very competitive industry in which the ability to develop and deliver advanced services through the Internet and other channels is a key competitive factor. There are significant risks in the development of new or enhanced services, including the risks that we will be unable to:

- o Effectively use new technologies;
- o Adapt our services to emerging industry or regulatory standards; or
- o Market new or enhanced services.

If we are unable to develop and introduce new or enhanced services quickly enough to respond to market or customer requirements or to comply with emerging industry standards, or if these services do not achieve market acceptance, our business could be seriously harmed.

INTERNET AND INTERNAL COMPUTER SYSTEM FAILURES OR COMPROMISES OF OUR SYSTEMS OR SECURITY COULD DAMAGE OUR REPUTATION AND HARM OUR BUSINESS.

Although a significant portion of our business is conducted using traditional methods of contact and communications such as face-to-face meetings, a portion of our business is conducted through the Internet. We could experience future

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system failures and degradations. We cannot assure you that we will be able to prevent an extended systems failure if any of the following events occurs:

- o Human error;
- o Subsystem, component, or software failure;
- o A power or telecommunications failure;
- o An earthquake, fire, or other natural disaster;
- o Hacker attacks or other intentional acts of vandalism; or
- o An act of God or war.

Any such systems failure that interrupts our operations could seriously harm our business. We currently have limited off-site data storage and disaster recovery systems.

The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and amount of traffic. Our future success will depend upon the development and maintenance of the Internet's infrastructure to cope with this increased traffic. This will require a reliable network backbone with the necessary speed, data capacity, and security, and the timely development of complementary products, such as high-speed modems, for providing reliable Internet access and services.

The secure transmission of confidential information over public networks is a critical element of our operations. We rely on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information over the Internet. To the best of our knowledge, to date, we have not experienced any security breaches in the transmission of confidential information. Moreover, we continually evaluate advanced encryption technology to ensure the continued integrity of our systems. However, we cannot assure you that advances in computer capabilities, new discoveries in the field of cryptography or other events or developments will not result in a compromise of the technology or other algorithms used by our vendors and us to protect client transaction and other data. Any compromise of our systems or security could harm our business.

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THERE ARE RISKS ASSOCIATED WITH OUR STOCK TRADING ON THE NASD OTC BULLETIN BOARD RATHER THAN A NATIONAL EXCHANGE.

There are significant consequences associated with our stock trading on the NASD OTC Bulletin Board rather than a national exchange. The effects of not being able to list our securities on a national exchange include:

- o Limited release of the market prices of our securities;
- o Limited news coverage of us;
- o Limited interest by investors in our securities;
- o Volatility of our stock price due to low trading volume;
- o Increased difficulty in selling our securities in certain states due to "blue sky" restrictions; and
- o Limited ability to issue additional securities or to secure additional financing.

IF OUR COMMON STOCK IS SUBJECT TO PENNY STOCK RULES, YOU MAY HAVE GREATER DIFFICULTY SELLING YOUR SHARES.

The Securities Enforcement and Penny Stock Reform Act of 1990 applies to stock

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characterized as "penny stocks," and requires additional disclosure relating to the market for penny stocks in connection with trades in any stock defined as a penny stock. The Securities and Exchange Commission has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions.

The exceptions include exchange-listed equity securities and any equity security issued by an issuer that has:

- net tangible assets of at least \$2,000,000, if the issuer has been in continuous operation for at least three years;
- net tangible assets of at least \$5,000,000, if the issuer has been in continuous operation for less than three years;
- or - average annual revenue of at least \$6,000,000 for the last three years.

Unless an exception is available, the regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks.

If our financial condition does not meet the above tests, then trading in the common stock will be covered by Rules 15g-1 through 15g-6 and 15g-9 promulgated under the Securities Exchange Act. Under those rules, broker-dealers who recommend such securities to persons other than their established customers and institutional accredited investors must make a special written suitability determination for the purchaser and must have received the purchaser's written agreement to a transaction prior to sale. These regulations would likely limit the ability of broker-dealers to trade in our common stock and thus would make it more difficult for purchasers of common stock to sell their securities in the secondary market. The market liquidity for the common stock could be severely affected.

WE DEPEND ON A LIMITED NUMBER OF KEY EXECUTIVES WHO WOULD BE DIFFICULT TO REPLACE.

Our success depends significantly on the continued services of our senior management, especially Leonard J. Sokolow, our Chief Executive Officer and President. Losing Mr. Sokolow or any of our subsidiaries' other key executives, including Timothy E. Mahoney, our Chairman and Chief Operating Officer; Robert F. Williamson, Jr., our Chief Financial Officer; David A. Spector, one of our Vice Presidents, and Marc N. Siegel, President of vFinance Investments, could seriously harm our business. We cannot assure you that we will be able to retain our key executives or that we would be able to replace any of our key executives if we were to lose their services for any reason. Competition for these executives is intense. If we had to replace any of these key executives, we would not be able to replace the significant amount of knowledge that these key executives have about our operations. We do not maintain "key person" insurance policies on any of our executives.

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WE RELY VERY HEAVILY ON CORRESPONDENT SERVICES CORP. ("CSC"), CLEARING BROKER FOR VFINANCE INVESTMENTS, OUR OPERATING BROKER-DEALER SUBSIDIARY. THE TERMINATION OF THE AGREEMENT BETWEEN THE CLEARING BROKER AND VFINANCE INVESTMENTS COULD HARM OUR BUSINESS.

Either party upon 60 days prior written notice may terminate the clearing agreement between CSC and us. According to the terms of the agreement, the clearing broker, on a fee basis, processes all securities transactions for the accounts of vFinance Investments and the accounts of its clients. CSC services include billing and credit extension, control and receipt, custody and delivery

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of securities, for which vFinance Investments pays a transaction charge. We are dependent on the operational capacity and the ability of CSC for the orderly processing of transactions. In addition, by engaging the processing services of a clearing broker, vFinance Investments is exempt from certain capital reserve requirements and other complex regulatory requirements imposed by federal and state securities laws. Moreover, vFinance Investments has agreed to indemnify and hold CSC harmless from certain liabilities or claims, including claims arising from the transactions of its clients.

OUR OPERATING BROKER-DEALER SUBSIDIARY EXTENDS CREDIT TO ITS CLIENTS AND IS SUBJECT TO RISKS AS A RESULT.

Our broker dealer clears all transactions for its customers on a fully disclosed basis with its clearing broker, CSC, which carries and clears all customer securities accounts. A limited portion of the customer securities activities of vFinance Investments are transacted on a "margin" basis, pursuant to which credit is extended to customers, which (a) is secured by cash and securities in customer accounts, or (b) involve (i) "short sales" (i.e., the sale of securities not yet purchased) or (ii) the purchase and sale of commodity futures contracts, substantially all of which are transacted on a margin basis. These risks are increased during periods of volatile markets in which the value of the collateral vFinance Investments holds could fall below the amount borrowed by its clients. If margin requirements are not sufficient to cover losses, vFinance Investments may be required to sell or buy securities at prevailing market prices and incur losses to satisfy its client obligations.

WE UNDERWRITE SECURITIES THROUGH VFINANCE INVESTMENTS AND ARE SUBJECT TO LOSSES RELATING TO A DECLINE IN THE MARKET VALUE OF SECURITIES THAT WE HOLD IN INVENTORY AND TO LIABILITY FOR ENGAGING IN UNDERWRITING ACTIVITIES.

The underwriting activities of vFinance Investments involve the purchase, sale or short sale of securities as a principal. As an underwriter, vFinance Investments agrees to purchase securities on a "firm commitment" basis and is subject to risk that it may be unable to resell securities or be required to dispose of securities at a loss. In connection with our investment-banking activities in which vFinance Investments acts as a manager or co-manager of public offerings of securities, we expect to make increased commitments through vFinance Investments of capital to market making activities in securities of those issuers. Any additional concentration of capital in the securities of those issuers held in inventory will increase the risk of loss from possible declines in the market price of those securities. In addition, under federal securities laws, other laws and court decisions with respect to underwriters' liabilities and limitations on the indemnification of underwriters by issuers, an underwriter is subject to substantial potential liability for misstatements or omissions of material facts in prospectuses and other communications with respect to securities offerings. Our potential liability through vFinance Investments as an underwriter is generally not covered by insurance. Moreover, underwriting commitments constitute a charge against net capital and the ability of vFinance Investments to make underwriting commitments may be limited by the requirement that it must at all times be in compliance with the net capital rule. For the twelve month period, the Company did not participate in any firm commitment underwritings.

Our success and ability to compete depend to a significant degree on our intellectual property. We rely on copyright and trademark law, as well as confidentiality arrangements, to protect our intellectual property. Our company owns the following federally registered marks: vFinance, Inc.(R), vFinance.com, Inc.(R), AngelSearch(R), and First Colonial Securities Group, Inc.(R). In addition, our company owns the following state registered marks: Union Atlantic LC and Union Atlantic Capital, L.C. We currently do not have any patents. The concepts and technologies we use may not be patentable. Our competitors or others may adopt product or service names similar to "vFinance.com," thereby

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impeding our ability to build brand identity and possibly leading to client confusion. Our inability to adequately protect the name "vFinance.com" would seriously harm our business. Policing unauthorized use of our intellectual property is made especially difficult by the global nature of the Internet and difficulty in controlling the ultimate destination or security of software or other data transmitted on it.

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The laws of other countries may afford us little or no effective protection for our intellectual property. We cannot assure you that the steps we take will prevent misappropriation of our intellectual property or that agreements entered into for that purpose will be enforceable. In addition, litigation may be necessary in the future to:

- o Enforce our intellectual property rights;
- o Determine the validity and scope of the proprietary rights of others; or
- o Defend against claims of infringement or invalidity.

Such litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources, either of which could seriously harm our business.

OUR BOARD OF DIRECTORS CAN ISSUE SHARES OF "BLANK CHECK" PREFERRED STOCK WITHOUT FURTHER ACTION BY OUR STOCKHOLDERS.

Our Board of Directors has the authority, without further action by the stockholders, to issue up to 2,500,000 shares of preferred stock (of which, 122,500 shares are designated as Series A Convertible Preferred Stock and were issued in connection with the merger with Colonial Direct Financial Group, Inc., and 50,000 shares are designated as Series B Convertible Preferred Stock and were issued in connection with the merger with Colonial Direct Financial Group, Inc.) in one or more series and to fix the rights, preferences, privileges and restrictions in each series of the preferred stock, including:

- o Dividend rights;
- o Conversion rights;
- o Voting rights, which may be greater or lesser than the voting rights of the common stock;
- o Rights and terms of redemption;
- o Liquidation preferences; and
- o Sinking fund terms.

The issuance of shares of preferred stock could adversely affect the voting power of holders of our common stock and the likelihood that these holders will receive dividends and payments upon liquidation of our company and could have the effect of delaying, deferring or preventing a change in control of our company. We do not plan to issue any additional preferred stock in the next twelve months.

WE MAY HAVE LIABILITIES TO CERTAIN HOLDERS OF OUR COMMON STOCK, AND OPTIONS WHICH ARE NOT INCLUDED IN THIS REGISTRATION STATEMENT.

In connection with the prior issuance of common stock and/or options to acquire our common stock, the Company granted registration rights, including "piggy-back" registration rights giving such holders the right to be included in any registration statement filed by the Company subsequent to the date of issuance of such stock or options. Additionally, certain employees have options to acquire Company stock with registration rights. The Company expects to file a registration statement on a Form S-8 for such employee shares and stock options. Notwithstanding the existence of the piggy-back registration rights, the Company

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has not elected to include in this Registration Statement any options whose exercise price exceeds \$0.31. The Company believes that all holders of restricted common stock are free to sell such stock without restrictions pursuant to the provisions of Rule 144(k) of the Securities Act of 1933. The Company may incur liability to certain holders of such piggy-back registration rights for the failure to include them in this Registration Statement.

ADDITIONAL DILUTION AS A RISK TO SHAREHOLDERS.

While we currently have outstanding 22,952,885 shares of common stock, options to purchase a total of 9,687,050 shares of common stock, warrants to purchase a total of 3,108,499 shares of common stock and senior convertible promissory notes initially convertible into 3,421,052 shares of common stock, we are authorized to issue up to 75,000,000 shares of common stock and are therefore able to issue additional shares without being required to obtain shareholder approval. If we issue additional shares, or if our existing shareholders exercise or convert their outstanding options or notes, our other shareholders may find their holdings drastically diluted, which if it occurs, means that they will own a smaller percentage of our company.

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ITEM 2. DESCRIPTION OF PROPERTY.

At December 31, 2000, our corporate headquarters was located at 6600 North Andrews Avenue, Suite 304, Fort Lauderdale Florida 33309, where we leased approximately 3,800 square feet of office space at a rental of \$87,883 per annum, under a lease that expires on April 30, 2002. On January 22, 2001, we sublet this office space on the same terms for the remaining term of such lease.

On January 13, 2001, we relocated our corporate headquarters to 3010 North Military Trail, Boca Raton, Florida 33431, where Colonial Direct Financial Group, Inc., our wholly owned subsidiary, leased approximately 15,750 square feet at a rental of \$271,791 per annum, under a lease which expires in 2008. This office space is also the corporate headquarters of all of our subsidiaries.

Beginning January 2000, we leased approximately 1600 square feet of office space at 1215 Hightower Trail, Building B, Suite 220, Atlanta, Georgia 30350, at a monthly rate of \$2,317.66, which lease expires in February 2003. This office space is a branch office of Union Atlantic Capital, L.C.

Colonial Direct Financial Group, Inc., which became our wholly-owned subsidiary after December 31, 2000, subleases its prior corporate headquarters located at 1499 West Palmetto Park Road, Suite 312, Boca Raton, Florida 33486, where Colonial Direct Financial Group, Inc. leased approximately 7,400 square feet of space at a rental of \$168,360 per annum, for the balance of the remaining term of such lease which expires in April 30, 2002.

The following information relates to the branch offices of First Colonial Securities Group, Inc.:

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Office Locations -----	Approximate Annual Square Footage -----	Lease Rental -----	Exp. -----
New York, NY	11,165	\$474,513	December
Paramus, NJ	2,578	\$43,182	December
Marlton, NJ	6,130	\$128,178	March 31

Colonial Direct Financial Group, Inc. remains liable on its prior New York branch office lease that was for approximately 4,425 square feet, at an annual rental rate of approximately \$126,500, for a term that expires May 16, 2002. Colonial Direct Financial Group, Inc. is actively seeking a subtenant or assignee for this office space and remains primarily responsible until such time as a subtenant or assignee is located and approved by the landlord.

Colonial Direct Financial Group, Inc. has entered into a sublease at its Marlton, NJ office location for the balance of the lease term for approximately 6,130 of the total square footage, at an annual rental rate of \$123,520.

The following information relates to the branch offices of First Level Capital, Inc.:

Office Locations -----	Approximate Annual Square Footage -----	Lease Rental -----	Exp. -----
New York, NY	3,300	\$105,036	March
Boca Raton, FL	1,171	\$27,659	October
Sarasota, FL	1,058	\$19,903	July
Red Bank, NJ	4,100	\$75,000	October

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Based on the terms of our merger with NW Holdings, Inc., NW Holdings, Inc. assigned to us and we assumed all the obligations of NW Holdings, Inc. under the lease at 50 Broadway, 24th Floor, New York, New York 10004, where NW Holdings, Inc. leased approximately 3,300 square feet at a rental of \$105,036 per annum, under a lease which expires on March 1, 2006.

The leases for the Boca Raton, FL, Sarasota, FL and Red Bank, NJ branch office locations of First Level Capital, Inc. were entered into by First Level Capital, Inc.

We consider the facilities of our company and our subsidiaries (excluding the branch offices of First Level Capital, Inc.) to be reasonably insured and adequate for the foreseeable needs of our company and our subsidiaries and we believe that similar facilities are available in the Atlanta, Georgia, South Florida, New York, and metropolitan areas at comparable rental rates.

ITEM 3. LEGAL PROCEEDINGS.

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From time to time a subsidiary of ours or we are named as a party to a lawsuit that has arisen in the ordinary course of business. Although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, we believe that such losses, if any, will not have a material adverse effect on our business, results of operations or financial position; however, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

The business of vFinance Investments involves substantial risks of liability, including exposure to liability under federal and state securities laws in connection with the underwriting or distribution of securities and claims by dissatisfied customers for fraud, unauthorized trading, churning, mismanagement and breach of fiduciary duty. In recent years, there has been an increasing incidence of litigation involving the securities industry, including class actions that generally seek rescission and substantial damages.

In the ordinary course of business, our company and/or its subsidiaries may be parties to other legal proceedings and regulatory inquiries, the outcome of which, either singly or in the aggregate, is not expected to be material. There can be no assurance however that any sanctions will not have a material adverse effect on the financial condition or results of operations of our company and/or its subsidiaries. What follows below is a brief summary of certain matters pending against or involving our subsidiaries and us.

First Colonial Securities Group, Inc. ("First Colonial") is subject to supervision and regulation by the NASD, the SEC and various state securities commissions. As part of this regulatory oversight, First Colonial is subject to periodic examination and inspections by these authorities. First Colonial has been advised that as a result of an examination performed by the Philadelphia office of the NASD for the years 1996 and 1997, the NASD identified several possible material deficiencies. The NASD and our company settled the matter in February 2002 with us paying a fine of \$75,000.

On April 5, 2001 Fleet National Bank ("Fleet") filed a complaint against Michael Golden ("Golden") , a former controlling shareholder of Colonial Direct Financial Group, Inc., one of our wholly owned subsidiaries ("Colonial Direct") and Colonial Direct in the Superior Court of New Jersey in the amount of \$315,902.94 for amounts due under Lines of Credit issued prior to our January 2001 acquisition of Colonial Direct. In October 2001, the Superior Court entered a summary judgment in favor of Fleet. The period for appeal of the summary judgment expired on December 10, 2001. Despite our joint liability with Michael Golden, we have fully accrued for and established reserves for this judgment.

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On April 5, 2001 Fleet filed a complaint against First Colonial Securities, Inc., a wholly owned subsidiary of Colonial Direct in the Superior Court of New Jersey in the amount of \$210,928.19 for a letter of credit issued prior to our January 2001 acquisition of Colonial Direct. In October 2001, the Superior Court entered a summary judgment in favor of Fleet. The period for appeal of the summary judgment expired on December 10, 2001. We have fully accrued for and established reserves (including reserves for net capital purposes) for this judgment.

On or about May 17, 2001, Golden filed an initial complaint against us in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida,

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alleging that we breached our January 5, 2001 employment agreement with Golden, which was entered into as a result of the merger between Colonial Direct and us. Mr. Golden claims that he terminated the agreement for "good reason," as defined in the agreement, and that we have failed to pay him severance payments and other benefits as well as accrued commissions and un-reimbursed expenses. In the initial complaint, Golden sought monetary damages from us in excess of \$50,000 together with interest, attorney's fees and costs.

On or about July 18, 2001, we filed our answer and affirmative defenses and counterclaims with the Circuit Court against Golden and Ben Lichtenberg ("Lichtenberg"), Golden's partner in Colonial Direct, denying all material allegations in the complaint, affirmatively alleging that Golden is not entitled to any severance payments because he was terminated for cause for his insubordination, failure to follow directives of our board of directors and for breaches of fiduciary duty to us. We also alleged that both Golden and Lichtenberg violated the merger agreement between Colonial Direct and us by breaching certain of the representations and warranties set forth in the merger agreement by, among other things, failing to advise us of certain loan agreement defaults, improperly withdrawing approximately \$400,000 of capital from Colonial Direct, failing to deliver a closing balance sheet and failing to disclose significant liabilities of Colonial Direct. Claiming that the activities of Golden and Lichtenberg constituted violations of Florida's Securities Investor Protection Act, common law fraud, breach of fiduciary duty, breach of contract, intentional interference with advantageous business relationships, and breach of the implied covenant of good faith and dealing, we are seeking indemnification under the merger agreement and additional monetary damages against Golden and Lichtenberg in excess of \$15,000.

In response to our answer, affirmative defenses and counterclaims, on or about September 1, 2001, Golden filed an amended complaint with the Court against us, Leonard Sokolow ("Sokolow"), our President and Chief Executive Officer, and Timothy Mahoney ("Mahoney"), the Chairman of our board of directors. In the amended complaint, Golden alleges that Sokolow and Mahoney made various false representations that induced Golden to enter into the merger agreement and his employment agreement. Golden is seeking monetary damages from Sokolow, Mahoney and us in excess of \$4.6 million.

Lichtenberg filed an answer, affirmative defenses and counterclaims with the Court in response to our filing with the Court on July 13, 2001. In addition to denying all material allegations in our July 13, 2001 counterclaims against him, Lichtenberg alleges that: (a) we breached our employment agreement with him, (b) Sokolow and the company made various false representations that induced Lichtenberg to enter into the merger agreement and (c) we materially breached the Colonial Direct merger agreement. Lichtenberg is seeking delivery from us of 414,825 shares of our common stock and monetary damages of at least \$488,000 from Sokolow and us, jointly and severally. On November 20, 2001 Sokolow and the company filed an answer and affirmative defenses to these allegations denying Lichtenberg's allegations. The parties are proceeding with discovery and the matter has been placed on the Circuit Court's September 2002 trial docket.

PROCEEDINGS INVOLVING FIRST COLONIAL SECURITIES GROUP, INC.

On May 15, 2001, Louis D'Alessio filed a claim with the NASD against First Colonial and Joel Kamphuis. His claim alleges compensatory damages in an amount between \$100,000 and \$500,000 plus unspecified punitive damages. He alleges unfair business practices, violation of the federal securities act, violation of state securities statutes, and common law fraud. vFinance Investments believes that their claim is without merit and is vigorously defending the action. We anticipate that this matter will result in a settlement of approximately \$15,000.

On January 22, 2002, Josephine and Frank Oliveri filed a claim with the NASD

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against First Colonial and Anthony Guglieri. Their claim alleges compensatory damages of \$192,286.50 plus interest and punitive damages of \$100,000. They allege unsuitable investments, unauthorized trading, excessive trading and lack of supervision. vFinance Investments believes that their claim is without merit and is vigorously defending the action. We anticipate that this matter will result in a settlement of approximately \$25,000.

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On October 3, 2001, Sterling Financial Investment Group filed a claim with the NASD against vFinance Investment, Michael Kraft, Mickey Dubberly and Jaret Brietstein. Their claim alleges compensatory damages and punitive damages to not exceed the sum of \$500,000. They alleged vFinance Investments offered and made significant cash payments to Sterling's employees, Kraft, Dubberly and Brietstein to entice them to break their written employment agreements with Sterling and work for vFinance Investments. vFinance Investments believes that their claim is without merit and is vigorously defending the action.

On August 14, 2001, Rosario Catanzarite, Joann Catanzarite, Anna Piegaro, Brian Catanzarite and Dina Catanzarite filed a claim with the NASD against First Colonial, Rodney Strong, Glen Merendino, Michael Golden, Lewis Maniloff, and Steven Schwartz. Their claim alleges compensatory damages in the amount of \$125,000 plus interest. They allege that Mr. Merendino completely abused their trust, processed unsuitable trades, coupled with abusive use of margin. vFinance Investments believes that their claim is without merit and is vigorously defending the action. We anticipate that this matter will result in a settlement of approximately \$25,000.

We are engaged in a number of other legal proceedings incidental to the conduct of our business. These claims aggregate a range of \$684,800 to \$1,919,000. In the opinion of our management, our company is adequately insured against the claims relating to such proceedings, and any ultimate liability arising out of such proceedings will not have a material adverse effect on the financial condition or results of operations of our company.

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

No matters were submitted to a vote of stockholders during the fourth quarter of our 2001 fiscal year.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

MARKET INFORMATION

Our common stock, par value \$0.01 per share, is traded on the OTC Bulletin Board of the National Association of Securities Dealers, Inc. under the symbol "VFIN."

From October 8, 1992 through December 31, 1993, our common stock and warrants were trading on the NASDAQ Small Cap Market under the symbols PFII and PFIIW, respectively, and on the Boston Stock Exchange under the symbols PFI and PFIW, respectively. In January 1994, our common stock and warrants were de-listed from both exchanges. The warrants expired in October 1995. From January 1994 until November 18, 1998, there was no public trading market for our common stock.

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The following table sets forth the closing high and low bid information for our common stock for the periods indicated below, as reported by the National Quotation Bureau during such periods:

2000	High	Low
1st Quarter	\$8.00	4.19
2nd Quarter	7.75	2.88
3rd Quarter	3.88	1.66
4th Quarter	1.88	0.63
2001		
1st Quarter	0.97	0.31
2nd Quarter	0.21	0.50
3rd Quarter	0.46	0.22
4th Quarter	0.88	0.15

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The foregoing quotations supplied by the National Quotations Bureau reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

We are authorized to issue 75,000,000 shares of common stock, of which 23,387,097 shares were issued and outstanding as of March 27, 2002. We are authorized to issue up to 2,500,000 shares of preferred stock, of which (i) 122,500 shares are designated as Series A Convertible Preferred Stock, par value \$0.01 per share, all of which are currently issued and outstanding, and (ii) 50,000 shares are designated as Series B Convertible Preferred Stock, par value \$0.01 per share, all of which are currently issued and outstanding. The number of stockholders of record for the Common Stock as of March 27, 2002 was 60.

We have not paid any cash dividends since inception, and we do not anticipate paying any cash dividend in the foreseeable future.

Our transfer agent is North American Transfer Co., Freeport, New York 11520.

RECENT SALES OF UNREGISTERED SECURITIES

PRIVATE PLACEMENTS. On June 1, 2000, we granted to each of Leonard J. Sokolow and Timothy E. Mahoney an option to purchase up to 500,000 shares of our common stock. On January 1, 2001, Messrs. Sokolow and Mahoney agreed to the cancellation of these options. On January 5, 2001, each of Mr. Sokolow and Mr. Mahoney received the right to be granted an option to purchase 500,000 shares of our common stock if he remained employed by our company for at least six months thereafter. These options were also cancelled on April 2, 2001.

On July 6, 2001, each of Mr. Sokolow and Mr. Mahoney received an option to purchase 500,000 shares of our common stock that expires on July 6, 2006, 25% of which vested upon grant and the remainder of which vests in three equal annual

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installments beginning July 6, 2002. The option grants to Messrs. Sokolow and Mahoney were exempt from registration pursuant to Section 4(2) of the Securities Act.

We recently sold the following equity securities to unaffiliated entities. The sales were exempt from registration pursuant to Section 4(2) of the Securities Act and/or Regulation D promulgated under the Securities Act.

As of December 18, 2001, Critical Infrastructure Fund (BVI), LP, purchased 877,193 shares of our common stock for \$250,000. See Item 101, "Description of Business - Our History" above. Pursuant to the terms of the sale, Critical Infrastructure Fund (BVI), LP, received registration rights incidental to a company registration of securities with the SEC with respect to these shares. Critical Infrastructure Fund (BVI), LP, subsequently sold some of these shares to Messrs. Williamson, Sokolow and Mahoney and the Elliot J. Brody Revocable Trust.

As of December 21, 2001, Innovex Partners purchased 980,392 shares and received a warrant to purchase 1,000,000 shares of our common stock at \$.35 per share for a purchase price of \$250,000. The warrant is immediately exercisable and expires on December 21, 2006.

As of January 7, 2002, AMRO International, S.A. purchased 350,878 shares of our common stock for \$100,000. Pursuant to the investment, AMRO was granted registration rights incidental to a company registration of securities with the SEC with respect to the shares.

As of March 27, 2002, there were options and warrants to purchase up to 13,300,549 shares of our common stock held by our employees and consultants and employees and consultants of our subsidiaries outstanding. Such options and warrants vest over a one month to four-year period and expire between 2004 and 2005. The per share exercise price ranges from \$0.28 to \$7.20. These options and warrants were exempt from registration pursuant to Section 4(2) of the Securities Act.

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ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, which was recently released by the SEC, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 2 to our consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods used by us.

GENERAL. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Actual results could differ from those estimates.

REVENUE RECOGNITION. We earn revenue from brokerage and trading which are

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recognized on the day of the trade. We also earn revenue from investment banking and consulting. Monthly retainer fees for investment banking and consulting are recognized as earned. Investment banking success fees are generally based on a percentage of the total value of a transaction and are recognized upon successful completion.

We do not require collateral from our customers. Revenues are not concentrated in any particular region of the country or with any individual or group.

We periodically receive equity instruments which include stock purchase warrants and common and preferred stock from companies as part of our compensation for investment-banking services that are classified as investments in trading securities on the balance sheet if still held at the financial reporting date. These instruments are stated at fair value in accordance with SFAS #11 "Accounting for certain investments in debt and equity securities" and EITF 00-8 "Accounting by a grantee for an equity instrument to be received in conjunction with providing goods or services." Primarily all of the equity instruments are received from small public companies. The stock and stock purchase warrants received are typically restricted as to re-sale. Though, the Company generally receives a registration right within one year. Company policy is to sell these securities in anticipation of short-term market movements. We recognize revenue for these stock purchase warrants when received based on the Black Scholes valuation model. On a monthly basis, we recognize unrealized gains or losses in the statement of operations based on the changes in value in the stock purchase warrants as determined by the Black Scholes valuation model. Realized gains or losses are recognized in the statement of operations when the related stock purchase warrant is exercised and sold. For the years ended December 31, 2001 and 2000 we recognized \$1,756,411 and \$1,501,654, respectively, of revenue in connection with the receipt of equity instruments.

Occasionally, we receive equity instruments in private companies with no readily available market value. Equity interests and warrants for which there is not a public market are valued based on factors such as significant equity financing by sophisticated, unrelated new investors, history of positive cash flow from operations, the market value of comparable publicly traded companies (discounted for liquidity) and other pertinent factors. Management also considers recent offers to purchase a portfolio company's securities and the filings of registration statements in connection with a portfolio company's initial public offering when valuing warrants.

Our policy was to distribute equity instruments or proceeds from the sale of equity instruments to our employees as compensation for their investment banking successes. These distributions complied with compensation agreements which varied on a "banker by banker" basis. Accordingly, unrealized gains or losses recorded in the statement of operations related to securities held by us at each period end which ultimately will be distributed to our employees, also impact compensation expense and accrued compensation. At December 31, 2001 and 2000, \$28,813 and \$0, respectively, of accrued payroll is owed to former employees of our company in connection with equity investments held by us that have not yet been distributed.

As of December 31, 2001, certain transactions in process may result in us receiving equity instruments or stock purchase warrants in subsequent periods as discussed above. In this event, we will recognize revenue related to the receipt of such equity instruments consistent with the aforementioned policies. In addition, we would also record compensation expense at fair value related to the distribution of some or all of such equity instruments to employees or independent contractors involved with the related transaction.

CLEARING ARRANGEMENT. We do not carry accounts for customers or perform custodial functions related to customers' securities. We introduce all of their customer transactions, which are not reflected in these financial statements, to

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their respective clearing brokers, which maintain the customers' accounts and clear such transactions. Additionally, our clearing firm provides the clearing and depository operations for our proprietary securities transactions. These activities may expose our broker dealer off-balance-sheet risk in the event that customers do not fulfill their obligations with the clearing broker, as our broker dealer has agreed to indemnify our clearing firm.

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CUSTOMER CLAIMS. In the normal course of business, our operating subsidiaries have been and continue to be the subject of numerous civil actions and arbitrations arising out of customer complaints relating to our activities as a broker-dealer, as an employer and as a result of other business activities. In general, the cases involve various allegations that our employees had mishandled customer accounts. Based on our historical experience and consultation with counsel, we typically reserve an amount we believe will be sufficient to cover any damages assessed against us. However, we have in the past been assessed damages that exceeded our reserves. If we misjudged the amount of damages that may be assessed against us from pending or threatened claims, or if we are unable to adequately estimate the amount of damages that will be assessed against us from claims that arise in the future and reserve accordingly, our operating income would be reduced.

FAIR VALUE. "Trading securities owned" and "Securities sold, not yet purchased" on our consolidated statements of financial condition are carried at fair value or amounts that approximate fair value, with related unrealized gains and losses recognized in our results of operations. The determination of fair value is fundamental to our financial condition and results of operations and, in certain circumstances, it requires management to make complex judgments.

Fair values are based on listed market prices, where possible. If listed market prices are not available or if the liquidation of our positions would reasonably be expected to impact market prices, fair value is determined based on other relevant factors, including dealer price quotations. Fair values for certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments or commodities, as well as time value and yield curve or volatility factors underlying the positions.

Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different pricing models or assumptions could produce different financial results. Changes in the fixed income and equity markets will impact our estimates of fair value in the future, potentially affecting principal trading revenues. The illiquid nature of certain securities or debt instruments also requires a high degree of judgment in determining fair value due to the lack of listed market prices and the potential impact of the liquidation of our position on market prices, among other factors.

INVESTMENTS. Investments are classified as trading securities and are held for resale in anticipation of short-term market movements or until such securities are registered or are otherwise unrestricted. Any unregistered securities received generally contain a registration right within one year. Trading account assets, consisting of marketable equity securities and stock purchase warrants, are stated at fair value. At December 31, 2001 and 2000, investments consisted entirely of common and preferred stock held for resale. Realized gains or losses are recognized in the statement of operations when the related stock purchase warrant is exercised and the underlying shares are sold. Unrealized gains or losses are recognized in the statement of operations on a monthly basis based on changes in the fair value of the security as quoted on national or inter-dealer stock exchanges. Net unrealized losses related to investments held for trading

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and stock purchase warrants as of December 31, 2001 and 2000, aggregated \$1,443,878 and \$424,041, respectively.

GOODWILL AND OTHER INTANGIBLE ASSETS ("FAS 142"). The provisions of FAS 141 eliminated the pooling-of-interests method of accounting for business combinations consummated after June 30, 2001. We adopted FAS 141 on July 1, 2001 and it did not have a significant impact on our financial position or results of operations. Under the provisions of FAS 142, goodwill and indefinite lived intangible assets are no longer amortized, but are reviewed annually for impairment. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. We are required to adopt the new accounting rules beginning January 1, 2002. Management is currently assessing the financial impact FAS 142 will have on the consolidated financial statements, but they do not believe it will be material.

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The value of the Company's goodwill is exposed to future adverse changes if the Company experiences declines in operating results or experiences significant negative industry or economic trends or if future performance is below historical trends. The Company periodically reviews intangible assets and goodwill for impairment using the guidance of applicable accounting literature. We are subject to financial statement risk to the extent that the goodwill and other intangible assets become impaired. During the year ended December 31, 2001, we did not record any impairment losses related to goodwill and other intangible assets. It is expected that the adoption of FAS 142 may result in a one-time, non cash charge.

NEW ACCOUNTING STANDARDS. In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, and the accounting and reporting provisions of APB Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS - REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS ("APB 30"). We are required to adopt the new accounting rules beginning January 1, 2002. Management is currently assessing the financial impact FAS 144 will have on the consolidated financial statements, but they do not believe it will be material.

YEAR ENDED DECEMBER 31, 2001 COMPARED TO THE YEAR ENDED DECEMBER 31, 2000

STATEMENTS OF OPERATIONS

Business Environment

The securities industry is highly competitive and sensitive to many factors and is directly affected by general economic and market conditions, including the volatility and price level of securities markets; the volume, size, and timing of securities transactions; the demand for investment banking services and changes in interest rates. All such conditions have an impact on commissions, trading and investment income as well as on liquidity. In addition, a significant portion of the Company's expenses are relatively fixed and do not

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vary with market activity. Consequently, substantial fluctuations can occur in the Company's revenues and net income from period to period due to these and other factors.

In addition, the Company has faced increasing competition from commercial banks and other sources as these institutions begin to offer more investment banking and financial services traditionally only provided by securities firms. The effect of the consolidation of the securities industry of recent years means that a variety of financial services companies have merged to offer a broader spectrum of investment products and such competitors have substantially greater financial resources than the Company. The Company is also experiencing increasing regulation in the securities industry, particularly affecting the over-the-counter markets, making compliance with regulations more difficult and costly. At present, the Company is unable to predict the extent of the changes, or their potential effect on the Company's business.

Outlook

The Company's long-term plan is to continue to expand existing offices by hiring experienced professionals, thus maximizing the potential of each office and expanding the development of existing trading, investment banking, investment advisory and other activities. Equally important is the search for viable acquisition candidates. As opportunities are presented, it is the intention of the Company to pursue growth by acquisition where a comfortable match can be found in terms of corporate goals and personnel and at a price that would provide the Company's shareholders with incremental value.

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Results of Operations

Markets in fiscal 2001 were extremely volatile, and ended the year with a substantial decline. Beginning in May 2000 declines in over-valued technology and telecommunications stocks, the ensuing loss of wealth, concerns over inflation and the slowing economy reduced investors participation in the equity markets. On September 11, 2001, attacks by terrorists on the World Trade Center and the Pentagon irretrievably damaged North America's sense of invulnerability at home. The repercussions have had and will have far reaching consequences beyond the personal losses experienced by many Americans and their families. An economy, already in recession, saw consumers reduce expenditures, reduce travel and brought business investment to a virtual halt. Despite continuing interest rate reductions and calls to resume normal behavior, the economy continued to limp along. Securities markets were negatively affected by issues surrounding the bankruptcy of Enron Corp. as investors remained uncertain and both economic and market conditions continue to be extremely volatile.

Company management believes that the impact of difficult business conditions provides the opportunity for expansion of the Company's business. As a result the Company made two acquisitions in early 2001. The Company intends to continue to expand as opportunities occur.

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The following table and discussion summarizes the changes in the major revenue and expense categories for the past two years (in thousands of U.S. dollars).

Total revenues were \$15,769,223 for the year ended December 31, 2001 as compared to \$5,517,480 for the year ended December 31, 2000, an increase of \$10,251,743, or 186%.

	For the year ended December 31			
	2001	% of Revenues	2000	% of Revenues
Revenues:				
Commissions - agency	\$6,799,700	43%	\$ -	0%
Commissions - principal	4,774,010	30%	-	0%
Success fees	2,493,671	16%	2,965,135	54%
Consulting and retainers	761,061	5%	2,193,889	40%
Other brokerage related income	567,077	4%	-	0%
Other	373,704	2%	358,456	6%
Total Revenues	\$15,769,223	100%	\$5,517,480	100%
Cost of revenues:				
Commissions	7,861,258	50%	3,051,257	55%
Clearing and transaction costs	1,754,446	11%	-	0%
Other	46,695	0%	-	0%
Total cost of revenues	9,662,399	61%	3,051,257	55%
Gross profit	6,106,824	39%	2,466,223	45%
Other Expenses:				
General and administrative	9,470,371	60%	3,665,063	66%
Write-off of goodwill	8,582,020	54%	-	0%
Net loss on trading securities	79,827	1%	236,006	4%
Professional fees	1,006,696	6%	478,841	9%
Provision for bad debts	349,049	2%	88,150	2%
Net unrealized loss on investments held for trading and stock purchase warrants	1,443,878	9%	424,041	8%
Depreciation and amortization	958,711	6%	1,682,324	30%
Amounts forgiven under forgivable loans	956,543	6%	-	0%
Stock based compensation	372,596	2%	-	0%
Total other expenses	23,219,691	147%	6,574,425	119%
Loss from operations	(17,112,867)	-109%	(4,108,202)	-74%
Interest and dividend income (expense)	(340,993)	-2%	196,553	4%
Net loss	\$ (17,453,860)	-111%	\$ (3,911,649)	-71%

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Investment banking and consulting was 21% of revenues or \$3,254,732 for the year ended December 31, 2001 as compared to 94% or \$5,159,025 for the year ended December 31, 2000, a decrease of 37% or \$1,904,293. The decrease was primarily due to a sharp decline in the stock market that in turn decreased demand for new security offerings from all companies and especially the small and medium size firm that we generally serve.

Cost of revenues was \$9,662,399 for the year ended December 31, 2001 as compared to \$3,051,257 for the year ended December 31, 2000, an increase of \$6,611,142. The chart below compares each of the three segments of our business revenues, cost of revenues, gross profit and gross profit margin for the years ended December 31, 2001 and 2000.

	Brokerage and Trading -----	Investment Banking Consulting -----	Other -----	Total -----
2000				
Revenues	\$ --	\$ 5,159,024	\$ 358,456	\$ 5,517,480
Cost of Revenues	--	3,051,257	--	3,051,257
Gross Profit	\$ --	\$ 2,107,767	\$ 358,456	\$ 2,466,223
	=====	=====	=====	=====
GROSS PROFIT MARGIN	--	40.9%	100.0%	44.7%
	=====	=====	=====	=====
2001				
Revenues	\$12,140,787	\$ 3,254,732	\$ 373,704	\$15,769,223
Cost of Revenues	8,655,602	960,102	46,695	9,662,399
	-----	-----	-----	-----
Gross Profit	\$ 3,485,185	\$ 2,294,630	\$ 327,009	\$ 6,106,824
	=====	=====	=====	=====
GROSS PROFIT MARGIN	28.7%	70.5%	87.5%	38.7%
	=====	=====	=====	=====

Gross profit was \$6,106,824 for the year ended December 31, 2001 as compared to \$2,466,223 for the year ended December 31, 2000, an increase of \$3,640,601 or 148%. Gross profit margin for the year ended December 31, 2001 was 38.7% as compared to 44.7% for the year ended December 31, 2000. The decrease in gross profit margin was due to lower margin brokerage commissions partially offset by increased investment banking and consulting gross profit margin.

General and administrative expenses were \$9,110,274 or the year ended December

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31, 2001 as compared to \$1,355,537 for the year ended December 31, 2000, an increase of \$7,754,701 or 572%. The primary reason for the increase was the addition of new personnel due to the three acquisitions made by us.

At December 31, 2001, we wrote off the unamortized goodwill of \$8,582,020 remaining from the acquisition of First Level, Colonial and Critical.

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We determined that, as of December 31, 2001, a write-down of the goodwill related to the NWH acquisition was necessary as our projections of the future operating results of First Level indicated impairment. Based on such projections and other analysis, we took an impairment charge aggregating \$876,000, related to NWH goodwill. Goodwill remaining as of December 31, 2001 totaled \$420,000. The remaining \$420,000 is a conservative estimate based on the following facts considered by management; All 21 First Level Capital employees at acquisition were with the company at December 31, 2001. First Level Capital operations were very clean with no compliance issues so the company decided to merge the broker dealer (BD) operations of vFinance Capital, Inc. and First Colonial Securities Group, Inc. into First Level Capital and change the name to that of the parent - vFinance Investments, Inc. Initial indications are that vFinance Investments, Inc. will be profitable in the first quarter of 2002.

We determined that, as of December 31, 2001, a write-down of the goodwill related to the Colonial acquisition was necessary as our projections of future operating results indicated impairment. Further, because we closed the operations formerly associated with Colonial and withdrawn its broker license, there does not appear to be a significant opportunity for any future operations. Therefore, we wrote off the entire remaining unamortized purchase goodwill of approximately \$7,400,000.

We determined that, as of December 31, 2001, a write-down of the goodwill related to the to the acquisition of Critical. We recorded an impairment of approximately \$250,000 and no goodwill remains at December 31, 2001.

Professional fees were \$1,006,696 for the year ended December 31, 2001 as compared to \$478,841 for the year ended December 31, 2000, an increase of approximately \$527,855. The increase was primarily due to increases in legal and accounting fees in association with the preparation of various regulatory filings and various legal and accounting issues, which arose from our growth.

Provision for bad debts was \$349,049 for the year ended December 31, 2001 as compared to \$88,150 for the year ended December 31, 2000, an increase of approximately \$260,899 or 296%. The increase was primarily due to increases in revenues and difficulties experienced collecting retainer fees in the difficult investment banking climate mentioned above. Retainer fees are recognized as services are provided. We provide for credit losses at the time we believe accounts receivable may not be collectible. Our evaluation is made and recorded on a monthly basis. Credit losses have not exceeded management's expectations. At December 31, 2001 accounts receivable totaled \$157,247; due to the uncertainty of the collectibility management has set up a \$63,528 reserve or 40% allowance for doubtful accounts. Accounts receivable result from the recognition of retainer fees as the service is provided on investment banking deals. \$289,000 of the provision for bad debts expense is directly related to retainer fee income of \$761,061 or 38%.

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Net unrealized loss on investments held for trading and stock purchase warrants was \$1,443,878 for the year ended December 31, 2001 as compared to \$424,041 for the year ended December 31, 2000, an increase of approximately \$1,019,837. The increase was primarily due to the prolonged decrease in the stock market.

Depreciation and amortization was \$958,711 for the year ended December 31, 2001 as compared to \$49,324 for the year ended December 31, 2000, an increase of \$909,387. Most of the increase was due to amortization of goodwill. .

At December 31, 2001 the company had \$307,452 currently due from employees and \$577,760 of long-term notes receivable from employees. These represent monies advanced to employees as a condition of employment. These advances are forgiven between 2-6 years as long as the employee remains with the Company. Management has provided this benefit to attract qualified employees. Amounts forgiven under forgivable loans of \$956,543 at December 31, 2001 relate primarily to advances given to new brokers. During its term, the loan ratably becomes income to the broker and an expense for us. If the broker leaves before forgiveness of the loan is completed, the remaining amount is immediately due and payable.

Stock based compensation was \$517,675 for the year ended December 31, 2001 as compared to \$3,941,726 for the year-ended December 31, 2000 a decrease of \$3,424,051. This decrease was due to management entering into far fewer agreements in 2001 involving payments in common stock (stock performance plans). It should also be noted that due to a decline in the stock price most of the compensation expense was picked up in the 1st year (2000). Stock based compensation included the issuance of common stock and common stock options. The common stock is valued at the fair value at the date of issuance. The fair value of the options is estimated using the Black-Scholes valuation model.

Interest and dividend income aggregating \$71,007 for the year ended December 31, 2001 and \$196,553 for the year ended December 31, 2000 relates to income earned on our cash balances. Our cash balance has decreased during the year.

We do not believe our operations are materially affected by inflation and or by seasonal fluctuations. Our main lines of business are directly affected by higher interest rates, the volatility of the stock market and capital markets, and are reliant on the continuation of mergers and acquisitions and related financings in the entrepreneurial marketplace.

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LIQUIDITY AND CAPITAL RESOURCES

We had \$1,826,474 and \$5,454,071 of cash and cash equivalents at December 31, 2001 and December 31, 2000, respectively, a decrease of \$3,627,597. The major components of this change are discussed below.

OPERATING ACTIVITIES:

For the year ended December 31, 2001, net cash used in operating activities was \$3,987,415 as compared to net cash used by operating activities of \$479,833 for the year ended December 31, 2000. The main components of this change are discussed below.

Write-off of goodwill for the year ended December 31, 2001 resulted in a non-cash charge of \$8,582,020.

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Non-cash fees received (primarily stock and stock warrants) resulted in a cash charge of \$1,756,411 and \$1,501,654 for the years ended December 31, 2001 and December 31, 2000, respectively.

Depreciation and amortization resulted in a non-cash charge of \$958,711 and \$49,324 for the years ended December 31, 2001 and December 31, 2000 respectively. Amortization of goodwill related to the acquisition of First Level and Colonial accounted for approximately \$550,000 for the year ended December 31, 2001. We no longer amortize goodwill.

Amortization of deferred compensation resulted in a non-cash charge of \$68,549 and \$1,682,234 for the years ended December 31, 2001 and December 31, 2000, respectively.

Issuance of common stock and common stock options in conjunction with services rendered resulted in a non-cash charge of \$449,125 and \$2,259,402 for the years ended December 31, 2001 and December 31, 2000, respectively.

Unrealized loss on the sale of investments resulted in a non-cash charge of \$1,443,878 and \$424,041 for the years ended December 31, 2001, and December 31, 2000, respectively.

Income taxes receivable increased \$110,402 as a result of an overpayment from the year ended December 31, 2000. As reflected in the cash flow statement, other assets have decreased by \$1,432,818 primarily as a result of the decrease in forgivable loans and prepaid acquisition costs.

INVESTING ACTIVITIES

For the year ended December 31, 2001, net cash used in investing activities was \$1,084,892 as compared to \$223,238 for the year ended December 31, 2000. The main components of this change are discussed below.

Purchases of equipment resulted in a cash charge of \$161,805 and \$155,614 for the years ended December 31, 2001 and December 31, 2000, respectively.

The acquisition of NW Holdings resulted in a cash charge of \$940,037 for the year ended December 31, 2001.

FINANCING ACTIVITIES

For the year ended December 31, 2001, net cash provided by financing activities was \$1,444,710 as compared to \$5,928,658 for the year ended December 31, 2000. The main components of this change are discussed below.

On November 28, 2001, we entered into a Note Purchase Agreement, as amended by subsequent letter agreements dated November 30, 2001, December 14, 2001, and December 28, 2001, February 13, 2002 and March 4, 2002 (collectively, the "Note Purchase Agreement"), with SBI Investments (USA) Inc. ("SBI"). Under the terms of the Note Purchase Agreement, SBI may provide a subordinated loan to us up to \$1,500,000 in the form of a 48-month non-interest bearing, convertible note. As of December 31, 2001, we have received \$975,000 under the Note Purchase Agreement and may receive, at SBI's option alone, an additional \$525,000 no later than June 30, 2002.

Proceeds for the issuance of common stock related to private placement, net of cash and stock issuance costs, resulted in cash increase of \$534,999 and \$5,928,658 for the years ended December 31, 2001 and December 31, 2000 respectively.

FUTURE AND CONTINGENT LIABILITIES:

The following statements are made in consideration of Financial Reporting Release (FR-61), LIQUIDITY AND OFF-BALANCE SHEET ARRANGEMENTS, CERTAIN TRADING ACTIVITIES, & TRANSACTIONS WITH RELATED AND CERTAIN OTHER PARTIES. We do not have "off-balance sheet arrangements."

We lease office space under the terms of operating leases. The following chart shows lease obligations including rental of real property and equipment.

Year	Amount
----	-----
2002	\$1,212,000
2003	1,129,000
2004	957,000
2005	917,000
2006	823,000
Thereafter	552,000

Total	\$5,590,000
	=====

Total rent expense under operating leases, including space rental, totaled approximately \$1,433,057 and \$79,646 for the years ended December 31, 2001 and 2000. We have total non-cancelable leases of \$2,446,177, included above, of which we have entered into sublease agreements with payments aggregating \$117,048 for the year ending December 31, 2002 and \$48,000 in each of the years ending December 31, 2003 through 2006.

In lieu of a security deposit, we have obtained a letter-of-credit from a commercial bank that is collateralized by a restricted cash deposit.

Litigation:

From time to time we are a party to various lawsuits that have arisen in the ordinary course of business. The amounts asserted in these matters are material to our financial statements. While any litigation contains an element of uncertainty and although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, management believes that such losses, if any, will not have a material adverse effect on our business, results of operations or financial position. However, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

For a description of this litigation, see Part I, Item 3 of this Annual Report.

Subsequent Events:

On January 25, 2002, we entered into a Credit Agreement with UBS Americas, Inc.

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("UBS"). Under the terms of the Credit Agreement, as amended on April 12, 2002, UBS provided a revolving credit facility of \$3,000,000 to us for the purpose of supporting the expansion of our brokerage business or investments in infrastructure to expand our operations or its broker-dealer operations. The loan has a term of 4 years and must be repaid in full by January 2005 and bears interest at LIBOR plus a LIBOR margin of 2%. We must make early repayments under the Credit Agreement if we acquire a new broker dealer firm, enter a new line of business, or hire more than 4 brokers in a single or related transaction. This repayment is made by adding \$1.00 to the cost of each incremental clearing transaction we make through CSC, a wholly-owned subsidiary of Paine Webber which is a wholly-owned subsidiary of UBS. We have not to date entered into a transaction that would trigger any repayment. We borrowed \$1,500,000 under the credit facility in January 2002. The Credit Agreement does not provide for conversion of the debt into our equity securities.

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In April 2002, we entered into a non-binding letter of intent with Somerset Financial Group, Inc. If the transaction is completed, for which there can be no assurance, we will acquire certain assets relating to Somerset's retail and insurance brokerage operations and will add to our operations approximately 45 registered representatives located in Connecticut, Long Island, New York, New Jersey and Minnesota. If we complete this transaction, we will issue to certain persons associated with Somerset warrants to purchase 500,000 shares of our common stock and, subject to the revenues generated by the acquired assets, up to 3,000,000 shares of our common stock. Because we are in the process of negotiating definitive agreements, the terms of this transaction are subject to change.

We anticipate that we will need additional debt or equity financing in order to carry out its long-term business strategy. Such strategy may be financed by bank borrowings, public offerings, private placements of equity or debt securities, or a combination of the foregoing.

We do not have any material commitments for capital expenditures over the course of the next fiscal year.

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ITEM 7. FINANCIAL STATEMENTS.

vFinance, Inc.

Consolidated Financial Statements

Years ended December 31, 2001 and 2000

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Report of Independent Auditors

Board of Directors
vFinance, Inc.

We have audited the accompanying consolidated balance sheet of vFinance, Inc. (formerly vFinance.com, Inc.) as of December 31, 2001 and the related consolidated statements of operations, shareholders' equity and cash flows for the years ended December 31, 2001 and 2000. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of vFinance, Inc. at December 31, 2001, and the results of its operations and its cash flows for the years ended December 31, 2001 and 2000, in conformity with accounting principles generally accepted in the United States.

/s/ Sherb & Co

New York, New York

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vFINANCE, INC.
CONSOLIDATED BALANCE SHEET

Year ended December 31, 2001

Assets:

Cash and cash equivalents	\$ 1,826
Restricted cash	203
Due from clearing broker	588
Investments in trading securities	1,077
Accounts receivable, net of allowance for doubtful accounts of \$63,528	93
Forgivable loans - employees, current portion	307
Notes receivable - employees, net of allowance for doubtful accounts of \$60,550	107
Prepaid expenses and other current assets	133

Total current assets	4,337
Furniture and equipment, at cost:	
Furniture and equipment	940
Internal use software	146

	1,087
Less accumulated depreciation	(403)

Net furniture and equipment	683
Forgivable loans - employees	577
Goodwill, net of accumulated amortization of \$699,294	420
Other assets	387

Total Assets	\$ 6,405
	=====
Liabilities and Shareholders' Equity:	
Accounts payable	\$ 1,093
Accounts payable - employees	66
Accrued Payroll	1,264
Accrued Interest	239
Other Accrued liabilities	815
Securities sold, not yet purchased	53
Lines of credit	297
Subordinated promissory notes	650
Notes payable, current portion	1,162
Capital lease obligations, current portion	12

Total current liabilities	5,656
Letter of credit and promissory note	268

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Capital lease obligations	56
Series A Convertible Preferred Stock, \$0.01 par value; 122,500 shares authorized; 122,500 shares issued and outstanding (liquidation preference of \$1,225,000 at December 31, 2001)	1
Series B Convertible Preferred stock, \$0.01 par value; 50,000 shares authorized; 50,000 issued and outstanding (liquidation preference of \$500,000 at December 31, 2001)	
Common stock, \$0.01 par value, 75,000,000 shares authorized; 25,964,395 shares issued, 22,952,885 outstanding	259
Additional paid-in-capital on preferred stock	1,565
Additional paid-in-capital on common stock	22,515
Deferred compensation	(82)
Accumulated deficit	(21,666)

	2,593
Less treasury stock, 3,011,510 shares	(2,169)

Total Shareholders' Equity	424

Total Liabilities and Shareholders' Equity	\$ 6,405
	=====

See accompanying notes.

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vFINANCE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,	
	2001	2000
	-----	-----
Revenues:		
Commissions - agency	\$ 6,799,700	\$ --
Commissions - principal	4,774,010	--
Success fees	2,493,671	2,965,135
Consulting and retainers	761,061	2,193,889
Other brokerage related income	567,077	--
Other	373,704	358,456
	-----	-----
TOTAL REVENUES	15,769,223	5,517,480
	-----	-----

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COST OF REVENUES:		
Commissions	6,901,156	--
Clearing and transaction costs	1,754,446	--
Success	715,608	2,397,804
Consulting and retainers	244,494	653,453
Other	46,695	--
	-----	-----
TOTAL COST OF REVENUES	9,662,399	3,051,257
	-----	-----
GROSS PROFIT	6,106,824	2,466,223
	-----	-----
OTHER EXPENSES:		
General and administrative	9,110,274	1,355,537
Write-off of goodwill	8,582,020	--
Net loss on trading securities	79,827	236,006
Professional fees	1,006,696	478,841
Legal settlements	215,018	800
Provision for bad debts	349,049	88,150
Net unrealized loss on investments held for trading and stock purchase warrants	1,443,878	424,041
Depreciation and amortization	958,711	49,324
Amounts forgiven under forgivable loans	956,543	--
Stock based compensation	517,675	3,941,726
	-----	-----
Total other expenses	23,219,691	6,574,425
	-----	-----
Loss from operations	(17,112,867)	(4,108,202)
Interest and dividend income (expense)	(340,993)	196,553
	-----	-----
NET LOSS	(17,453,860)	(3,911,649)
	-----	-----
Less: Preferred stock dividend	157,500	--
	-----	-----
LOSS AVAILABLE TO COMMON STOCKHOLDERS	\$ (17,611,360)	\$ (3,911,649)
	=====	=====
Loss per share:		
Basic	\$ (0.89)	\$ (0.39)
	=====	=====
Weighted average number of common shares used in computing basic loss per share	19,810,285	10,131,616
	=====	=====
Diluted	\$ (0.89)	\$ (0.39)
	=====	=====
Weighted average number of common shares used in computing diluted loss per share	19,810,285	10,131,616
	=====	=====

See accompanying notes.

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vFINANCE, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Preferred Stock		Common Stock		Additional Paid-in Capital Common
	Shares	Amount	Shares	Amount	
Balances at December 31, 1999	--	\$ --	9,099,400	\$ 90,994	\$ 5,097,410
Issuance of common shares in connection with private placement (net of cash issuance costs of \$1,071,342 and non cash issuance costs of \$361,333)	--	--	2,333,334	23,334	5,905,324
Purchase of treasury stock	--	--	--	--	--
Issuance of common shares in connection with services rendered	--	--	538,333	5,383	2,539,361
Change in per share fair value of common shares under restricted stock performance plan (First Tranche Shares)	--	--	--	--	(3,740,872)
Amortization of deferred compensation under restricted stock performance plan (First Tranche Shares)	--	--	--	--	--
Issuance of common shares under the restricted stock performance plan (Second Tranche Shares)	--	--	3,011,111	30,111	7,498,667
Change in per share fair value of common shares under restricted stock performance plan (Second Tranche Shares)	--	--	--	--	(4,987,665)
Rescission of common shares under the restricted stock performance plan (Second Tranche Shares)	--	--	--	--	--
Issuance of compensatory stock options and stock purchase warrants	--	--	--	--	128,783
Amortization of deferred compensation (Second Tranche Shares)	--	--	--	--	--
Amortization of deferred compensation	--	--	--	--	--
Net loss	--	--	--	--	--
Balances at December 31, 2000	--	--	14,982,178	149,822	12,441,008
issuance of shares in conjunction with merger of NW Holdings, Inc.	--	--	1,700,000	17,000	1,697,750
Issuance of shares in					

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conjunction with merger of Colonial	172,500	1,725	5,750,000	57,500	6,105,139
Accrued dividends payable on preferred shares	--	--	--	--	--
Issuance of common shares in connection with legal settlements	--	--	180,000	1,800	67,900
Amortization of deferred compensation	--	--	--	--	--
Purchase of treasury stock, at cost	--	--	--	--	--
Issuance of shares in conjunction with acquisition of Critical	--	--	400,000	4,000	320,000
Issuance of common shares in connection with services rendered	--	--	682,867	6,829	369,596
Issuance of shares in conjunction with related party share purchase agreement	--	--	877,193	8,772	241,228
Issuance of shares to investors	--	--	1,392,157	13,921	271,078
Other grants of stock options and stock purchase warrants	--	--	--	--	27,000
Sale of treasury stock, at cost	--	--	--	--	--
Beneficial conversion on Softbank note purchase agreement	--	--	--	--	975,000
Net loss	--	--	--	--	--
Balances at December 31, 2001	172,500	\$1,725	25,964,395	\$259,644	\$ 22,515,699

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	Additional Paid-in Capital Preferred	Deferred Compensation	Accumulated Deficit	Treasury Stock	Share E
Balances at December 31, 1999	\$ --	\$ (4,760,452)	\$ (300,850)	\$ --	\$
Issuance of common shares in connection with private placement (net of cash issuance costs of \$1,071,342 and non cash issuance costs of \$361,333)	--	--	--	--	5
Purchase of treasury stock	--	--	--	(6,822)	
Issuance of common shares in					

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connection with services rendered	--	(280,000)	--	--	2
Change in per share fair value of common shares under restricted stock performance plan (First Tranche Shares)	--	3,740,872	--	--	
Amortization of deferred compensation under restricted stock performance plan (First Tranche Shares)	--	675,813	--	--	
Issuance of common shares under the restricted stock performance plan (Second Tranche Shares)	--	(7,528,778)	--	--	
Change in per share fair value of common shares under restricted stock performance plan (Second Tranche Shares)	--	4,987,665	--	--	
Rescission of common shares under the restricted stock performance plan (Second Tranche Shares)	--	2,159,946	--	(2,159,946)	
Issuance of compensatory stock options and stock purchase warrants	--	(128,783)	--	--	
Amortization of deferred compensation (Second Tranche Shares)	--	381,167	--	--	
Amortization of deferred compensation	--	625,344	--	--	
Net loss	--	--	(3,911,649)	--	(3)
	-----	-----	-----	-----	-----
Balances at December 31, 2000	--	(127,206)	(4,212,499)	(2,166,768)	6
issuance of shares in conjunction with merger of NW Holdings, Inc.	--	--	--	--	1
Issuance of shares in conjunction with merger of Colonial	1,723,275	--	--	--	7
Accrued dividends payable on preferred shares	(157,500)	--	--	--	
Issuance of common shares in connection with legal settlements	--	--	--	--	
Amortization of deferred compensation	--	68,549	--	--	
Purchase of treasury stock, at cost	--	--	--	(10,392)	
Issuance of shares in conjunction with acquisition of Critical	--	--	--	--	
Issuance of common shares in connection with services rendered	--	--	--	--	
Issuance of shares in conjunction with related party share purchase agreement	--	--	--	--	
Issuance of shares to investors	--	--	--	--	
Other grants of stock options and stock purchase warrants	--	(24,000)	--	--	
Sale of treasury stock,					

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at cost	--	--	--	7,732	
Beneficial conversion on Softbank note purchase agreement	--	--	--	--	--
Net loss	--	--	(17,453,860)	--	(17,453,860)
Balances at December 31, 2001	<u>\$1,565,775</u>	<u>\$ (82,657)</u>	<u>\$ (21,666,359)</u>	<u>\$ (2,169,428)</u>	<u>\$ (21,835,783)</u>

See accompanying notes.

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vFinance, Inc.

Consolidated Statements of Cash Flows

	Years Ended D
	----- 2001 -----
OPERATING ACTIVITIES	
Net loss	\$(17,453,860)
Adjustments to reconcile net loss to net cash used in operating activities:	
Write-off of goodwill	8,582,020
Non-cash fees received	(1,756,411)
Depreciation and amortization	958,711
Amortization of deferred compensation	68,549
Issuance of common stock and common stock options in conjunction with services rendered and legal settlements	449,125
Provision for doubtful accounts	20,621
Unrealized loss on sale of investments, net	1,443,878
Loss on sale of investments, net	79,827
Proceeds from sale of investments	405,056
Beneficial Conversion factor expense	412,000
Changes in operating assets and liabilities, net of businesses acquired:	
Accounts receivable	207,677
Due from clearing broker	257,000
Notes and other receivable	426,641
Notes receivable from employees	61,774
Investments in trading securities	381,659
Income taxes receivable	(110,402)
Other assets	1,432,818
Accounts payable and accrued liabilities	134,475
Securities, sold not yet purchased	11,427

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Net cash used in operating activities	(3,987,415)
INVESTING ACTIVITIES	
Purchase of equipment	(161,805)
Prepaid transaction costs	--
Acquisition of NW Holdings, Inc., net of cash acquired	(940,037)
Acquisition of Colonial, net of cash acquired	12,024
Acquisition of Critical, net of cash acquired	7,586

Net cash used in investing activities	(1,082,232)
FINANCING ACTIVITIES	
Payments of capital leases	(65,289)
Proceeds from the note purchase agreement	975,000
Proceeds from issuance of common stock related to private placement, net of cash and stock issuance costs	534,999
Purchase of treasury stock, net	(2,660)

Net cash provided by financing activities	1,442,050

(Decrease) increase in cash and cash equivalents	(3,627,597)
Cash and cash equivalents at beginning of year	5,454,071

Cash and cash equivalents at end of year	\$ 1,826,474
	=====

See accompanying notes.

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vFinance, Inc.

Notes to the Consolidated Financial Statements

December 31, 2001

1. DESCRIPTION OF BUSINESS

vFinance, Inc. (the "Company") changed its name from vFinance.com, Inc. effective December 28, 2001. The Company is a "new-breed" financial services enterprise committed to building a worldwide audience of individuals looking to create wealth through their equity investments and businesses and the name change reflects the broader scope of services. The Company principally operates in one business segment, investment management services, consisting primarily of financial services, including retail brokerage and investment banking.

On January 4, 2001, the Company executed a merger agreement whereby it agreed to acquire all of the capital stock of NW Holdings, Inc. ("NWH"), a Florida corporation. On the Closing Date of the merger, NWH was the parent company of and wholly owned First Level Capital, Inc. ("First Level"), a Florida corporation whose name was subsequently changed to vFinance Investments, Inc. ("VFI"). First Level contained the primary operations of NWH and was an investment-banking firm that was licensed to conduct activities as a

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broker-dealer in 49 states and had offices in New York, New Jersey and Florida. VFI, as the Company's wholly owned subsidiary, continues to provide investment-banking services to small and medium sized companies and retail brokerage services to companies, financial institutions and individual investors.

On January 4, 2001, the Company also executed a merger agreement whereby it agreed to acquire all of the outstanding capital stock of Colonial Direct Financial Group, Inc. ("Colonial") a Delaware corporation. At the time of the merger, Colonial was a holding company comprised of two diversified financial services companies, First Colonial Securities Group, Inc. and Colonial Direct Retirement Services, Inc., and a company that provides administrative support to these financial service companies. The Colonial group of companies is now inactive.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

1. DESCRIPTION OF BUSINESS (CONTINUED)

On August 20, 2001, the Company entered into a Securities Exchange Agreement acquiring all of the membership interests in two related companies, Critical Investments, LLC, a Delaware limited liability company ("Critical Investments"), and Critical Advisors, L.L.C., a Virginia limited liability company ("Critical Advisors") (collectively "Critical"). Critical Investments manages and is the sole general partner in Critical Infrastructure Fund, L.P. ("Critical Infrastructure LP"), a Delaware limited partnership. Critical Advisors manages Critical Infrastructure Fund, Ltd. ("Critical Infrastructure Ltd."), an international business company organized and existing under the laws of the British Virgin Islands and receives (i) a management fee equal to 1% of the net asset value of Critical Infrastructure Ltd. and (ii) a performance fee equal to 20% of the increase in the net asset value of Critical Infrastructure Ltd. Critical Infrastructure LP and Critical Infrastructure Ltd. are the sole partners in, owning 96% and 4% respectively, and conduct their investment and trading activities through Critical Infrastructure Fund (BVI), LP, a limited partnership organized and existing under the laws of the British Virgin Islands which holds a portfolio of securities. Critical Investments and Critical Advisors changed their names to vFinance Investors, LLC and vFinance Advisors, LLC, subsequent to the acquisition.

The Company now conducts its broker/dealer operations and investment banking and consulting through VFI, a licensed broker dealer. It also operates its vFinance.com website through vFinance Holdings, Inc. and manages Critical Infrastructure Fund (BVI) LP through vFinance Advisors, LLC and vFinance Investors, LLC.

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS

Basis of Presentation

The consolidated financial statements include the accounts of the Company and

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its wholly owned subsidiaries. All intercompany accounts have been eliminated in consolidation. Certain amounts for the prior year financial statements have been reclassified to conform to the current year presentation.

Revenue Recognition

The Company earns revenue (commissions) from brokerage and trading which are recognized on the day of the trade - trade date basis. The Company also earns revenue from investment banking and consulting. Monthly retainer fees for investment banking and consulting are recognized as services are provided. Investment banking success fees are generally based on a percentage of the total value of a transaction and are recognized upon successful completion.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Revenue Recognition (continued)

The Company does not require collateral from its customers. Revenues are not concentrated in any particular region of the country or with any individual or group.

The Company may receive equity instruments which include stock purchase warrants and common and preferred stock from companies as part of its compensation for investment-banking services that are classified as investments in trading securities on the balance sheet, if still held at the financial reporting date. These instruments are stated at fair value in accordance with SFAS #115 "Accounting for certain investments in debt and equity securities" and EITF 00-8 "Accounting by a grantee for an equity instrument to be received in conjunction with providing goods or services." Primarily all of the equity instruments are received from small public companies. The stock and the stock purchase warrants received are typically restricted as to resale. Though, the Company generally receives a registration right within one year. Company policy is to resell these securities in anticipation of short-term market movements. The Company recognizes revenue for such stock purchase warrants when received based on the Black Scholes valuation model. On a monthly basis the Company recognizes unrealized gains or losses in the statement of operations based on the changes in value in the stock purchase warrants as determined by the Black Scholes valuation model.

Realized gains or losses are recognized in the statement of operations when the related stock purchase warrant is exercised and sold. For the years ended December 31, 2001 and 2000, the Company recognized \$1,756,411 and \$1,501,654 of revenue in connection with the receipt of equity instruments.

Occasionally, the Company receives equity instruments in private companies with no readily available market value. Equity interests and warrants for which there is not a public market are valued based on factors such as significant equity financing by sophisticated, unrelated new investors, history of positive cash flow from operations, the market value of comparable publicly traded companies

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(discounted for liquidity) and other pertinent factors. Management also considers recent offers to purchase a portfolio company's securities and the filings of registration statements in connection with a portfolio company's initial public offering when valuing warrants.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Revenue Recognition (continued)

As of December 31, 2001, certain transactions in process may result in the Company receiving equity instruments or stock purchase warrants in subsequent periods as discussed above. In such event, the Company will recognize revenue related to the receipt of such equity instruments consistent with the aforementioned policies.

The Company sells two types of listings to its website: (i) perpetual listings to venture capital vendors, who are interested in providing services to other companies or individuals; and (ii) three-month listings to entrepreneurs who have new business ideas to sell. Revenue related to the listings is generally recognized over the terms of such listings. Website revenues are concentrated primarily in the United States but are not concentrated in any particular region of the country or with any individual or group. Fees related to such listings are included in "other" in the statements of operations for the years ended December 31, 2001 and 2000.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results may differ from those estimates, and such differences may be material to the financial statements.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Cash and cash equivalents

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Cash and cash equivalents include all highly liquid investments with maturities of three months or less when purchased.

Accounts and Notes Receivable.

Accounts and note receivable balances are reviewed monthly to determine the collectible of such receivables. The Company records both a specific and general reserve on such balances as deemed appropriate. Notes receivable are generally from employees and result from commission advances and deficits that made be generated by trading adjustments or open customer balances.

Investments

Investments are classified as trading securities and are held for resale in anticipation of short-term market movements or until such securities are registered or are otherwise unrestricted. Any unregistered securities received contain a registration right within one year. Trading account assets, consisting of marketable equity securities and stock purchase warrants, are stated at fair value. At December 31, 2001 and 2000, investments consisted of common and preferred stock and stock purchase warrants held for resale. Realized gains or losses are recognized in the statement of operations when the related stock purchase warrant is exercised and the underlying shares are sold. Unrealized gains or losses are recognized in the statement of operations on a monthly basis based on changes in the fair value of the security as quoted on national or inter-dealer stock exchanges. Net unrealized losses related to investments held for trading and stock purchase warrants as of December 31, 2001 and 2000, aggregated \$1,443,878 and \$424,041.

New Accounting Standards

In July 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No.'s 141, BUSINESS COMBINATIONS ("FAS 141") and 142, GOODWILL AND OTHER INTANGIBLE ASSETS ("FAS 142"). The provisions of FAS 141 eliminated the pooling-of-interests method of accounting for business combinations consummated after June 30, 2001. The Company adopted FAS 141 on July 1, 2001 and it did not have a significant impact on the Company's financial position or results of operations. Under the provisions of FAS 142, goodwill and indefinite lived intangible assets are no longer amortized, but are reviewed annually for impairment. Separable intangible assets that are not deemed to have an indefinite life will continue to be amortized over their useful lives. The Company is required to adopt the new accounting rules beginning January 1, 2002. Management is currently assessing the financial impact FAS 142 will have on the consolidated financial statements, but it will not be material.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

New Accounting Standards (continued)

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In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, and the accounting and reporting provisions of APB Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS - REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS, AND EXTRAORDINARY, UNUSUAL AND INFREQUENTLY OCCURRING EVENTS AND TRANSACTIONS ("APB 30"). The Company is required to adopt the new accounting rules beginning January 1, 2002. Management is currently assessing the financial impact FAS 144 will have on the consolidated financial statements, but does not believe it will be material.

Stock Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES ("APB 25"), and related interpretations in accounting for its employee stock options and employee stock purchase warrants because the alternative fair value accounting provided for under Statement of Financial Accounting Standards No. 123, ACCOUNTING FOR STOCK BASED COMPENSATION ("SFAS 123"), requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, if the exercise price of the Company's employee stock options or stock purchase warrants equals or exceeds the market price of the underlying stock on the date of grant no compensation expense is recognized.

From time to time the Company may distribute equity instruments or proceeds from the sale of equity instruments to its employees. At December 31, 2001, \$28,811 of accrued payroll was owed to former employees of the Company in connection with equity instruments held that have not yet been distributed. At December 31, 2001 and 2000, \$254,625 and \$227,548 of accrued payroll was owed to current employees of the Company in connection with equity investments received as compensation.

Fair Value of Financial Instruments

The fair values of the Company's financial instruments, which includes cash and cash equivalents, accounts receivable, investments, accounts payable, and accrued expenses approximate their carrying values.

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash with high quality FDIC-insured financial institutions.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Furniture and Equipment

Furniture and equipment are stated on the basis of cost less accumulated

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depreciation and consists primarily of computer equipment. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, 2-5 years, for financial reporting purposes. Depreciation expense for the years ended December 31, 2001 and 2000, totaled \$259,417 and \$31,658, respectively.

Goodwill

The carrying values of goodwill as well as other long-lived assets are reviewed if the facts and circumstances suggest that they may be impaired. If this review indicates that the assets will not be recoverable, as determined based on the undiscounted estimated cash flows of the Company over the remaining amortization period, the Company's carrying values of the assets would be reduced to their estimated fair values in accordance with Statement of Financial Accounting Standards No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF. See Note 4.

Income Taxes

The Company accounts for income taxes under the liability method in accordance with Statement of Financial Accounting Standards No. 109, ACCOUNTING FOR INCOME TAXES. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Statement of Cash Flows

Non-cash items affecting the statements of cash flows are as follows:

	2001

Prepaid and accrued consulting and professional fees	\$ --
Issuance of stock purchase warrants in connection with employment agreements and asset acquisition with former Pinnacle partners	--
Issuance of common stock related to the Second Tranche of restricted stock performance plan	--

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Change in fair market value of stock issued in connection with Second Tranche of restricted stock performance plan	--
Rescission of Second Tranche of restricted stock performance plan	--
Change in fair market value of stock issued in connection with First Tranche of restricted stock performance plan	--
Beneficial conversion related to Softbank note payable	975,000
Accrual of Series A and B Preferred Stock dividends	157,500

Earnings per Share

The Company calculates earnings per share in accordance with Statement of Financial Accounting Standards No. 128, EARNINGS PER SHARE ("SFAS No. 128"). In accordance with SFAS No. 128, basic earnings per share is computed using the weighted average number of shares of common stock outstanding and diluted earnings per share is computed using the weighted average number of shares of common stock and the dilutive effect of options and warrants outstanding, using the "treasury stock" method. The Company had 4,181,927 and 0 options and warrants that potentially are dilutive, respectively at December 31, 2001 and 2000, not included in diluted earnings per share because the options and warrants would be anti-dilutive because the company had a net loss.

Accounts Payable, Employees

The amount reflected under this caption represents a total of reimbursable expenses (ie. mileage costs, meals & entertainment, travel and other) that are due to active employees of the company at the end of a reported period.

Forgivable Loans

At times management has advanced monies to employees as an inducement. These advances are characterized on the balance sheet as Forgivable loans. These advances are forgiven and recognized as compensation expense between 2-6 years as long as the employee remains with the Company. If the broker leaves before forgiveness of the loan is completed, the remaining amount is immediately due back from the employee.

Due from Clearing Broker

Receivables from brokers and dealers consist primarily of amounts due from the Company's clearing organization, which provides clearing and depository services for brokerage transactions on a fully disclosed basis.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

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3. ACQUISITIONS

As previously noted, on January 4, 2001, the Company closed on the merger of Colonial, acquiring all of its outstanding capital stock. The acquisition was accounted for under the purchase method of accounting. The results of operations of Colonial for the period January 1, 2001 through January 3, 2001 were not material. The purchase price consisted of the issuance of 5,750,000 common shares of stock, the issuance of 625,000 stock options, the conversion of 490,000 stock options, the issuance of 585,000 common stock purchase warrants and the issuance of 172,500 preferred shares of stock for total consideration of approximately \$7,400,000. The 5,750,000 common shares were valued at \$0.81 per share or (\$4,657,500), which was the closing price on January 4, 2001. The 625,000 stock options were valued at \$0.58 per share or (\$362,500) as determined by the Black-Scholes valuation model. The conversion of the 490,000 stock options were valued at \$0.58 per share or (\$284,200) as determined by the Black-Scholes valuation model. The 585,000 common stock purchase warrants were valued at \$0.58 per share or (\$339,300) as determined by the Black-Scholes valuation model. The 172,500 preferred shares were valued at the liquidation preference value of \$10 per share or (\$1,725,000). The purchase price was allocated to the assets acquired and the liabilities assumed with the excess of such purchase price of approximately \$8,100,000 allocated to goodwill, which was being amortized over 15 years. (See Note 4.) The Colonial merger shares were issued on a pro rata basis to shareholders based on their relative ownership of Colonial common stock, except for twenty percent (20%) of the 5,750,000 common shares of stock, totaling approximately 1,150,000 shares, which were withheld from the Majority Shareholders and placed in escrow for a term of six months subject to offset by the Company to cover losses or damages to the Company due to breaches by the Majority Shareholders of their representations, warranties or covenants contained in the Colonial merger agreement. The Company has made a claim of offset seeking a return of all Colonial merger shares held in escrow to cover certain losses or damages to the Company due to breaches by the Majority Shareholders of their representations, warranties or covenants contained in the Colonial merger agreement. Such claims have not been resolved and the shares remain in escrow. See Note 10.

As previously noted, on January 4, 2001, the Company closed on the merger of NWH acquiring all of its outstanding capital stock. The acquisition was accounted for under the purchase method of accounting. The results of operations of NWH for the period from January 1, 2001 through January 3, 2001, were not material. The purchase price consisted of the issuance of 1,700,000 common shares of stock, the issuance of 575,000 stock options and cash of \$1,000,000 for total consideration of \$2,714,750. The 1,700,000 common shares were valued at \$0.81 per share, or (\$1,377,000) which was the closing price on January 4, 2001. The 575,000 stock options were valued at \$0.58 per share, or (\$333,500) as determined by the Black-Scholes valuation model. The purchase price was allocated to the assets acquired and the liabilities assumed with the excess of such purchase price of approximately \$1,300,000 allocated to goodwill, which was being amortized over 15 years. (See Note 4.)

As previously noted on August 20, 2001, the Company closed on the acquisition of all of the membership interests of Critical for total consideration of approximately \$325,000 and the results of operations of Critical are included in the consolidated results of operations from August 20, 2001. The \$325,000 consideration consists of 400,000 common shares valued at \$0.36 per share (\$144,000), which was the closing price on August 20, 2001, and 500,000 options and warrants valued at \$0.36 per share (\$180,000) as determined by the Black-Scholes valuation model. The Company recorded approximately \$270,000 of goodwill, related to the excess of the purchase price over the fair value which was being amortized over 15 years (see Note 4). The acquisition is immaterial to the consolidated financial statements taken as a whole.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

3. ACQUISITIONS (CONTINUED)

The results of operations of Colonial and NWH are included in the Company's consolidated results of operations for the year ended December 31, 2001 from their respective acquisition dates (January 4, 2001), accordingly, no pro forma results of operations are presented for the year ended December 31, 2001 as the Company's consolidated results of operations include substantially all of each company's actual results.

In accordance with Financial Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" we have included all vested stock options issued by the company in exchange for outstanding awards held by employees of the acquiree as part of the purchase price. In August 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS ("FAS 144"), which addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, ACCOUNTING FOR THE IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF, and the accounting and reporting provisions of APB Opinion No. 30, REPORTING THE RESULTS OF OPERATIONS - REPORTING THE EFFECTS OF DISPOSAL OF A SEGMENT OF A BUSINESS ("APB 30"). We are required to adopt the new accounting rules beginning January 1, 2002. Management is currently assessing the financial impact FAS 144 will have on the consolidated financial statements, but they do not believe it will be material.

The following unaudited pro-forma condensed financial information reflects the results of operations and assets of the Company, Colonial and NWH as if the transactions had taken place on January 1, 2000, but does not purport to be indicative of the consolidated results of operations or financial position of the combined entities if the transactions had been consummated on January 1, 2000

	Year ended December 31, 2000 -----
Revenues	\$28,163,609
Net loss	(8,267,009)
Loss per share	(0.42)
Total assets	12,927,733

4. IMPAIRMENT OF GOODWILL

In connection with the aforementioned mergers and acquisition, the Company recognized goodwill as follows: First Level, approximately \$1,300,000; Colonial, approximately \$8,100,000; and Critical, approximately \$270,000. See Note 3 above.

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Management determined that, as of December 31, 2001, a write-down of the goodwill related to the NWH acquisition was necessary as the Company's projections of the future operating results of First Level indicated impairment. Based on such projections and other analysis the Company took an impairment charge aggregating \$876,000 related to NWH goodwill. Goodwill remaining as of December 31, 2001 totaled \$420,000. The remaining \$420,000 is a conservative estimate based on the following facts considered by management; All 21 First Level Capital employees still remained with the company at December 31, 2001. The Company consolidated the operations of its various broker dealers for the period ended December 31, 2001 and changed its operating name to vFinance Investments, Inc.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

4. IMPAIRMENT OF GOODWILL (CONTINUED)

Management determined that, as of December 31, 2001, a write-down of the goodwill related to the Colonial acquisition was necessary as the Company's projections of future operating results indicated impairment. Further, as the Company has closed the operations formerly associated with Colonial and withdrawn its broker license, there does not appear to be a significant opportunity for any future operations. Therefore, the Company wrote off the entire remaining unamortized purchase goodwill of approximately \$7,400,000 which is reflected in the Company's brokerage and trading business segment.

Management determined that, as of December 31, 2001, a write-down of the goodwill related to the to the acquisition of Critical was necessary. Thus, the Company recorded an impairment of approximately \$250,000 and no goodwill remains at December 31, 2001. Such write-down is reflected in the Company's other business segment.

The Company reported approximately \$8,500,000 of goodwill write-downs for the year ended December 31, 2001 related to the three acquisitions. This amount is included in the statement of operations under "write-off of goodwill."

5. RELATED PARTY TRANSACTIONS

On November 8, 1999, the Company entered into three year employment agreements (the "Agreements") with the Company's Chief Executive Officer and Vice Chairman, who is the beneficial owner of 16.1% and 21% of the total outstanding common shares of the Company at December 31, 2001 and 2000, respectively, and the Company's Chief Operating Officer and Chairman, who is the beneficial owner of 16.1% and 21% of the total outstanding common shares of the Company at December 31, 2001 and 2000, respectively (collectively the "Primary Shareholders"). Under the terms of the Agreements, which are renewable as directed by a majority vote of the board of directors, each individual shall receive (i) an initial base salary of \$150,000 per annum for the first year with a 5% increase per annum beginning one year from the date of the Agreements (the Company's board of directors may increase such salaries at their discretion); (ii) discretionary bonuses as determined by the Company's board of directors primarily based on

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each individuals performance; and (iii) incentive compensation paid monthly equal to Available Cash, as defined, primarily based on performance of the Company and its respective subsidiaries. The Agreements also contain provisions related to severance and change of control upon the occurrence of such events. Such Agreements were amended on January 5, 2001 and the salary was increased to \$208,000 per annum. The Company made payments to each of the Primary Shareholders aggregating \$326,789 and \$282,000 for the years ended December 31, 2001 and 2000, respectively, in connection with these Agreements.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

5. RELATED PARTY TRANSACTIONS (CONTINUED)

On June 1, 2000, the Company granted to each of its Primary Shareholders, 500,000 stock options in connection with certain stock option agreements that were part of their respective employment agreements. The stock options were granted at an exercise price that exceeded the stock price on the date of issuance and were exercisable over a three-year period, beginning on June 1, 2000. On January 1, 2001, the Primary Shareholders forfeited the 1,000,000 options by signing an Options Cancellation Agreement with the Company. No compensation expense was recognized related to these stock options in the year ended December 31, 2000, as the grant price exceeded the quoted market price on the date of the grant.

On January 5, 2001 the Company modified the Agreements with its Primary Shareholders giving them the right to receive a grant of 500,000 stock options to each at an exercise price that exceeded the stock price on the date of the modification. These modified grants would not have taken effect until certain conditions, including continued employment, were met. These grants were cancelled before any of the conditions were met.

On July 6, 2001, the Company modified the Agreements with its Primary Shareholders granting 500,000 stock options to each at an exercise price that exceeded the stock price on the date of issuance and were exercisable over a five-year period, beginning on July 6, 2001. No compensation expense was recognized related to these stock options in the year ended December 31, 2001, as the grant price exceeded the quoted market price on the date of the grant.

On October 6, 2000, the Company entered into promissory notes (the "Notes") with the three Union Atlantic employees subject to the Employment Agreements, as defined in Note 7. The Notes were for approximately \$150,000 and bore interest at a rate of 7%. The Notes, including interest, were due and payable within 30 days of the registration of common shares owned by the individuals and were secured by such common shares. The Notes were repaid in full with the proceeds from the sale of the commons shares in November 2001.

On December 18, 2001, Critical Infrastructure Fund (BVI), LP, purchased 877,193 shares of the Company's common stock for \$250,000 and received registration rights incidental to a Company registration of securities with the SEC with respect to these shares. Critical Infrastructure Fund (BVI), LP, subsequent to year end sold some of these shares to individual officers of the vFinance,

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including its Chief Executive Officer and Vice-Chairman, at \$0.285 per share, the price at which the shares were sold.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

6. INCOME TAXES

Deferred income taxes reflect the net income tax effect of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and amounts used for income taxes.

Deferred income taxes reflect the net income tax effect of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and amounts used for income taxes. The Company's deferred income tax assets and liabilities consist of the following:

	Year Ended December 31,	
	2001	2000
Net operating loss carryforwards	\$ 3,295,515	\$ 121,665
Deferred compensation amortization	639,283	494,440
Unrealized losses	546,014	51,357
Goodwill impairment	3,027,949	--
Other	465,248	--
Allowance for doubtful accounts	47,150	8,227
Gross deferred income tax assets	8,021,159	675,689
Depreciation	(64,560)	(26,201)
Other	--	(41,483)
Gross deferred income tax liabilities	(64,560)	(67,684)
Deferred income tax asset valuation allowance	(7,956,599)	(608,005)
Net deferred income tax assets	\$ --	\$ --

Net operating loss carryforwards totaled \$8,577,672 at December 31, 2001. The net operating loss carryforwards will begin to expire in the year 2021 if not utilized. After consideration of all the evidence, both positive and negative,

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management has recorded a valuation allowance at December 31, 2001 and 2000, due to the uncertainty of realizing the deferred income tax assets.

The Company has recorded an income tax receivable of \$201,000 as a result of an overpayment expected to be refunded in the subsequent year. This amount is included in the other assets caption on the balance sheet.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

7. EMPLOYMENT AGREEMENTS

On December 17, 1999, the Company entered into employment agreements with three individuals (the "Employment Agreements"). In connection with the Employment Agreements the Company issued 773,500 shares of its common stock (the "First Tranche Shares"). However, the First Tranche Shares were subject to divestment and return to the Company in the event and to the extent that certain performance criteria and/or other employment conditions were not met. The First Tranche Shares issued to employees were held in escrow until (i) cessation of the employee's employment with the Company prior to December 31, 2000, in which event all of the shares would be immediately returnable to the Company or (ii) the employee failed to meet certain cash revenue goals by February 15, 2001, as defined by the Employment Agreements, in which event such shares, or a percentage of such shares, would be immediately returnable to the Company, based on a formula contained in each Employment Agreement.

On August 18, 2000, the Company entered into amended and restated employment agreements (the "Amended Employment Agreements") with the same three individuals. The Amended Employment Agreements (i) modified the performance criteria and employment conditions under the Employment Agreements to provide, among other things, that the First Tranche Shares issued to the employees be held in escrow until (a) cessation of the employee's employment with the Company prior to October 6, 2000, in which event all of the First Tranche Shares would be immediately returnable to the Company or (b) the employee failed to meet certain cash revenue goals by February 15, 2001, as defined by the Employment Agreements, in which event the First Tranche Shares, or a percentage of such shares, would be immediately returnable to the Company, based on a formula contained in each Employment Agreement, and (ii) provided for the Company to issue an additional 3,011,111 shares of its common stock, which shares are subject to divestment and similar performance criteria (the "Second Tranche Shares"). The Second Tranche Shares issued to employees were split into two equal pieces and were being held in escrow until (i) cessation of the employees employment with the Company prior to December 31, 2001 (for one-half of the Second Tranche Shares) and December 31, 2002 (for one-half of the Second Tranche Shares), respectively, in which event all or a portion of such shares, respectively, would be immediately returnable to the Company or (ii) the employee fails to meet certain cash revenue goals by September 30, 2001 (for one-half of the Second Tranche Shares) and September 30, 2002 (for one-half of the Second Tranche Shares) respectively, as defined by the Amended Employment Agreements, in which event such shares, or a percentage of such shares, respectively, would be immediately returnable to the Company, based on a formula contained in each Amended Employment Agreement.

vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

7. EMPLOYMENT AGREEMENTS (CONTINUED)

The Amended Employment Agreements were accounted for as restricted stock performance plans. In a restricted stock performance plan, the nature of the restriction results in the compensation cost being measured at the date when the number of shares to be awarded is known. Consequently, the measurement of compensation at the date the performance criteria are met, measures the ultimate compensation to be recognized by the Company. These employment agreements were variable plans, therefore, interim estimates of compensation were required based on the fair market value of the common stock as of the end of the reporting period and the extent or degree of compliance with the performance criteria. Accordingly, in connection with the First Tranche Shares, the Company initially recorded deferred compensation aggregating \$3,828,825, based on the fair market value of the Company's common stock when the shares were issued. Based on the change in the fair market value of the Company's stock and the attainment of the required performance criteria, the Company recognized compensation expense of \$675,813 related to the First Tranche Shares during the year ended December 31, 2000. On November 10, 2000, the Company released the First Tranche Shares to the individuals as they had met the required performance criteria.

In connection with the Second Tranche Shares, on August 18, 2000, the Company initially recorded deferred compensation aggregating \$7,528,778, based on the fair market value of the Company's common stock when the shares were issued. Compensation expense for the Second Tranche Shares of \$381,167 was recognized through December 23, 2000. On December 23, 2000, the Company further amended and restated the Amended Employment Agreements to reduce the income tax consequences for the employees. These amendments superseded the August 18, 2000 Amended Employment Agreements, canceling and rescinding the Second Tranche Shares under the restricted stock performance plan. Upon cancellation of the Second Tranche Shares, the Company recorded the remaining unamortized deferred compensation of \$2,159,946 as treasury stock.

The Amended Employment Agreements provided for the Company to grant an additional 3,011,111 stock options to the individuals on January 23, 2001 that would have begun vesting on June 30, 2001. The employees resigned in June 2001 before any options had vested, and such options were forfeited.

vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

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December 31, 2001

8. SHAREHOLDER'S EQUITY

On January 3, 2000, the Company entered into an asset purchase agreement and employment agreements with two individuals, who were former partners in Pinnacle Capital Group, L.C. (now known as Union Atlantic Capital, L.C., a wholly owned subsidiary), for a term of three years. The assets purchased were furniture and fixtures owned individually by the key personnel. The acquisition was consummated on the premise that the two individuals would be bringing a significant amount of new business to the Company, hence the employment agreements were a condition of the asset purchase agreement. The consideration consisted of stock purchase warrants giving the two employees rights to purchase 190,000 shares of the Company's common stock at an exercise price of \$2.50 per warrant. The warrants are exercisable for a period of five years, at the discretion of the holders and had a fair value, as determined by the Black Scholes model of \$285,000; the Company allocated \$280,000 to deferred compensation and \$5,000 to furniture acquired. This \$280,000 was being amortized over the term of the respective employment agreements; however, during the year ended December 31, 2000, the employees were separated from the Company, and accordingly, the deferred compensation expense relating to the warrants was fully amortized. The employment agreements also granted each individual 200,000 stock options, which were forfeited in connection with their separations.

In March 2000, the Company increased the number of authorized common shares from 20,000,000 to 25,000,000. In addition, the Company established Preferred Stock, authorizing 2,500,000 shares, subject to the rights, preferences and privileges as determined by the Board of Directors. Further, on December 28, 2001, the Company increased the number of authorized common shares from 25,000,000 to 75,000,000.

As part of the Colonial transaction discussed in Note 1, the Company was authorized to issue up to 2,500,000 shares of preferred stock, of which (i) 157,500 shares were designated as Series A Convertible Preferred Stock, par value \$0.01 per share, all of which are currently issued and outstanding, and (ii) 50,000 shares were designated as Series B Convertible Preferred Stock, par value \$0.01 per share, all of which are currently issued and outstanding. All of the Series A and Series B shares were delivered to Colonial shareholders. The Series A and Series B Preferred Stock accrues annual dividends of 10% and 7%, respectively, on a quarterly basis. Accrued but unpaid dividends earn no interest. During the year ended December 31, 2001, \$157,500 of such dividends were accrued.

Series A and B Preferred Stock have the following rights, preferences, privileges and restrictions:

LIQUIDATION PREFERENCE. In the event of any liquidation or winding up of the Company, the holders of the Series A and B Preferred Stock will be entitled to receive, in preference to the holders of Common Stock, an amount equal to \$10 per share, plus unpaid dividends, if any. A consolidation or merger shall be deemed a liquidation or winding up for purposes of the liquidation preference.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

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December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

DIVIDEND RIGHTS. The holders of Series A and B Preferred Stock will be entitled to receive cumulative dividends in preference to holders of Common Stock at the rate of \$1 and \$0.70 per share annum (10% and 7% of the liquidation preference price) for Series A and B, respectively, whether or not earned or declared.

CONVERSION PRICE ADJUSTMENTS. The conversion price of the Series A and B Preferred Stock will be subject to adjustments to prevent dilution, on the weighted average basis, in the event the Company issues additional shares, at a purchase price of \$2.60 per share.

VOTING RIGHTS. The holders of Series A and B Preferred Stock have no voting rights.

REDEMPTION RIGHTS. The Company, at its option, may redeem, in whole or in part, the shares of Series A and B Preferred Stock outstanding, at any time, upon notice given, at a redemption price of \$11 and \$10 per share, respectively. If the Company receives proceeds from a single sale of its equity securities of at least \$500,000, the holders of Series A and B Preferred Stock may require the Company to redeem all, but not less than all, the Series B Preferred Stock at a redemption price equal to \$10 per share.

In 2000, the Company closed on a \$7 million round of private financing (the "Private Placement"), \$3,500,000 of which closed on March 31, 2000 and \$3,500,000 of which closed on August 17, 2000 (collectively the "Closing Dates"), before cash registration and issuance costs of \$1,071,342. As part of the Private Placement, on the Closing Dates, the Company issued (i) to certain banks and institutional investors 2,333,334 shares of the Company's common stock and 1,866,667 stock purchase warrants at exercise prices ranging from \$3.00-\$6.00 per share (ii) to other parties a total of 229,999 warrants, of which 83,333 warrants were issued to agents, 46,666 warrants were issued to employees for placing the financing and 100,000 warrants were issued to a company for a finder's fee. The warrants have exercise prices ranging from \$2.50 to \$7.20 and are exercisable on the earlier of a) one year from the effective date of the registration statement filed by the Company covering the securities issued and to be issued to the investors or b) three or four years, as the case may be, as defined in the agreements from the closing date. In conjunction with the 46,666 warrants, which were issued with prices below fair value, the Company recognized \$49,583 of compensation expense in the year ended December 31, 2000.

The warrants issued to non-employees in conjunction with the Private Placement were for services related to the Private Placement and have a fair value of \$361,333 as determined by the Black Scholes valuation model. Such amounts have been recorded as additional issuance costs.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

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8. SHAREHOLDER'S EQUITY (CONTINUED)

On May 2, 2000, the Company granted 20,000 options to a consultant. The stock options were granted as consideration for future services at an exercise price of \$5.00 and are exercisable over a four-year period, beginning May 2, 2001. The fair value of the options granted was estimated to be \$79,200 at the date of grant using the Black Scholes valuation model and will be ratably expensed over the term services are to be provided. During 2001 the Company amortized \$19,800.

On August 18, 2000, the Company entered into Amended Employment Agreements (see Note 6 above) with three individuals. The Amended Employment Agreements provided for the Company to grant an additional 400,000 stock options to individuals. The stock options were granted at an exercise price of \$3.15 and were exercisable over a four-year period, beginning on August 18, 2001 and were canceled upon their separation from the Company.

On August 30, 2001 and on October 16, 2001, the Company granted 673,500 stock purchase warrants to certain individuals and 878,427 stock options to employees in conjunction with the individuals purchase of common stock of the Company from existing shareholders. One stock option was granted for each share of common stock purchased by the individuals. The stock options were granted at above fair market value an exercise price of \$0.35 and vested on the date of grant.

On October 16, 2001, the Company granted 120,000 options to an individual in conjunction for serving on the Board of Directors for fiscal 2002. The stock options were granted as consideration for future services at an exercise price of \$0.35 and are exercisable on October 16, 2004. The fair value of the options granted was estimated to be \$24,000 at the date of grant using the Black Scholes valuation model and will be ratably expensed over the term services are to be provided. The remaining fair value of the shares is stated as deferred compensation at December 31, 2001.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

On November 28, 2001, the Company entered into a Note Purchase Agreement, as amended by subsequent letter agreements dated November 30, 2001, December 14, 2001, and December 28, 2001, February 13, 2002 and March 4, 2002 (collectively, the "Note Purchase Agreement"), with SBI Investments (USA) Inc. ("SBI"). Under the terms of the Note Purchase Agreement, SBI may provide a subordinated loan to the Company of up to \$1,500,000 in the form of a 48-month non-interest bearing, convertible note. As of December 31, 2001, the Company had received \$975,000 under the Note Purchase Agreement and may receive, at SBI's option alone, an additional \$525,000 no later than June 30, 2002. The note is convertible, at SBI's option, into as many as 5,263,158 shares of our common stock at \$0.285 per share. The Company, at any time during the first three years of the agreement, can call for redemption of the note for \$1,750,000, canceling the option or forcing the conversion of the note into shares of common stock.

Further, if SBI funds the full amount of the loan, SBI will become a party to an

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Investor Right Agreement and, as additional consideration the Company will issue to SBI an option to purchase up to that number of shares of its common stock equal to 1,500,000 divided by the average closing bid and ask price of its common stock for the 20 consecutive trading days preceding the date of SBI's exercise notice to the Company, but in no event will the per share price be more than \$0.336 or less than \$0.23. The Note Purchase Agreement was amended to extend the expiration date of the option past June 30, 2002 as the date for the funding of the third Tranche was extended.

In accordance with EITF Issue No. 00-27 (APPLICATION OF ISSUE NO. 98-5), ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OF CONTINGENTLY ADJUSTABLE CONVERSION RATIOS, TO CERTAIN CONVERTIBLE INSTRUMENTS, and APB # 21 the Company recorded a beneficial conversion feature and an imputed interest factor related to the Note Purchase Agreement of \$563,000. The Company fully expensed any beneficial conversion factor due to the fact that the SBI Note was immediately convertible. The net one time charge to the financial statements was \$412,000. The imputed interest will be accreted ratably over the term of the loan as additional interest expense.

As of December 31, 2001 the \$975,000 note payable was netted against the \$563,000 corresponding asset (imputed interest), therefore \$412,000 appears on the face of the balance sheet. Amortization of the imputed interest will begin in January 2002.

On December 21, 2001, the Company entered into an agreement whereby Innovex Partners purchased 980,392 common shares at \$0.255 per share and were granted a warrant to purchase 1,000,000 shares of common stock at \$0.35 per share. The warrant is immediately exercisable and expires on December 21, 2006.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

The Company has elected to follow Accounting Principle Board Opinion No. 25, Accounting for Stock Issued to Employees ("APB 25"), and related interpretations in accounting for its employee stock options because the alternative fair value accounting provided under FASB Statement No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, ("SFAS 123") requires the use of option valuation models that were not developed for use in valuing employee stock options. As permitted, the Company adopted the disclosure alternative of SFAS 123. Under APB 25, when the exercise price of the Company's stock options equals or exceeds the fair value of the underlying stock on the date of grant, no compensation expense is recorded.

A summary of the stock option activity for the years ended December 31, 2000 and 2001 is as follows:

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	Weighted Average	Exercise Price	Number of Shares	Exe P
		-----	-----	-----
Outstanding Options at December 31, 1999		\$4.19	1,065,000	\$2
Granted		4.69	2,615,000	1
Forfeited		6.00	(520,000)	4

Outstanding Options at December 31, 2000			3,160,000	
Granted		0.79	13,441,567	0
Forfeited		2.13	(6,914,517)	0

Outstanding Options at December 31, 2001		0.98	9,687,050	0
			=====	

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

The following table summarizes information concerning stock options outstanding at December 31, 2001.

Weighted Average Exercise Price	Number Outstanding
-----	-----
\$0.35	3,508,427
0.63	3,920,000
1.00	822,000
2.25	471,623
3.00	210,000
3.25	100,000
4.00	220,000
4.13	30,000
4.25	75,000
4.50	5,000
5.00	260,000
5.63	50,000
6.00	15,000

	9,687,050
	=====

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A summary of the warrant activity for the years ended December 31, 2000 and 2001 is as follows:

	Weighted Average	Exercise Price	Number of Shares
		-----	-----
Outstanding Warrants at December 31, 1999		\$2.50	10,000
Granted		5.84	2,286,666

Outstanding Warrants at December 31, 2000			2,296,666
Granted		0.97	1,978,500
Forfeited		5.81	(1,166,667)

Outstanding Warrants at December 31, 2001		2.73	3,108,499
			=====

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

The following table summarizes information concerning warrants outstanding at December 31, 2001.

Weighted Average Exercise Price	Number Outstanding
-----	-----
0.35	993,500
0.63	400,000
2.25	585,000
2.50	300,000
6.00	129,999
7.20	700,000

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3,108,499
=====

The weighted average grant-date fair value of warrants granted during the year equaled \$2.73 and \$5.84 for the years ended December 31, 2001 and 2000, respectively. The weighted average grant-date fair value of options granted during the year equaled \$0.98 and \$4.69 for the years ended December 31, 2001 and 2000, respectively. For purposes of pro forma disclosures, the estimated fair value of the options and warrants is amortized to expense over their respective vesting periods. The weighted average remaining contractual life for warrants outstanding at December 31, 2001 and 2000, is 3.62 years and 3.50 years respectively. The weighted average remaining contractual life for options outstanding at December 31, 2001 and 2000, is 4.33 years and 4.50 years respectively.

Options granted to employees are exercisable according to the terms of each agreement, ranging from one month to four years. At December 31, 2001 and 2000, 3,452,760 and 1,168,000 options outstanding were exercisable with weighted average exercise prices of \$1.49 and \$3.51, respectively. At December 31, 2001 and 2000, 12,795,549 and 5,456,666 total shares of the Company's common stock are reserved for issuance related to stock options and stock purchase warrants which were outstanding at December 31, 2001 and 2000, respectively.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

8. SHAREHOLDER'S EQUITY (CONTINUED)

Pro forma information regarding net loss is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options under the fair value method. The fair value for options and warrants granted was estimated at the date of grant using the Black Scholes option pricing model with the following weighted-average assumptions: for 2001 risk-free interest rates of 3.53%; no dividend yields; volatility factor of the expected market price of the Company's common stock of 1.610 for options and warrants and an expected life of the options and warrants of 4-5 years; for 2000: risk-free interest rates ranging from 5.52% to 6.57%; no dividend yields; volatility factor of the expected market price of the Company's common stock ranging from 0.771 to 1.92; and an expected life of the options and warrants of 4-5 years. The Company's pro forma net loss for the years ended December 31, 2001 and 2000 was \$ 17,702,620 and \$7,611,842, respectively. The Company's pro forma basic and diluted net loss income per share for the years ended December 31, 2001 and 2000 was \$0.89 and \$0.75, respectively. The impact of the Company's pro-forma net loss and loss per share of the SFAS 123 pro forma requirements are not likely to be representative of future pro forma results.

The Company recorded deferred compensation of \$24,000 and \$408,783 during the years ended December 31, 2001 and 2000 respectively in connection with the grants of employee stock options with exercise prices lower than the deemed fair

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value per share of the Company's common stock on the date of the grant. Such amounts are being amortized over the vesting period, and accordingly, \$3,000 and \$116,250 of compensation expense was recognized in the years ended December 31, 2001 and 2000 relative to such options.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

9. DEBT

Lines of credit

On April 5, 2001 Fleet National Bank ("Fleet") filed a complaint against Michael Golden ("Golden"), a former controlling shareholder of Colonial, in the Superior Court of New Jersey in the amount of \$315,903 for Lines of Credit issued prior to Company's January 2001 acquisition of Colonial. In October 2001, the Superior Court entered a summary judgment in favor of Fleet and the line of credit became due immediately. The period for appeal of the summary judgment expired on December 10, 2001. The Company has established reserves for this judgment due to the uncertainty surrounding the financial position of Golden. The reserves are included on the balance sheet in the liabilities section under the caption, Lines of Credit. The Company has accrued \$297,656, which management believes is adequate.

Subordinated promissory notes

Prior to its acquisition by the Company, Colonial entered into a \$650,000 bridge loan with three investors. The notes became due in November and December 2001. Interest for these loans is being accrued at the stated rate, 10 percent.

Notes payable

Prior to its acquisition by the Company, Colonial entered into a loan agreement with one of its principal shareholders. Its obligation under this loan, if any, is subject to litigation. The Company cannot establish when or if it will be required to repay this loan, carried at \$500,000, that is the obligation of its inactive Colonial subsidiary. Interest for this loan is being accrued at the Company's weighted average interest rate, 10 percent.

On April 5, 2001, Fleet filed a complaint against First Colonial Securities, Inc., a wholly owned subsidiary of Colonial in the Superior Court of New Jersey in the amount of \$210,928 for a letter of credit issued prior to the January 2001 acquisition of Colonial. In October 2001, the Superior Court entered a summary judgment in favor of Fleet and the letter of credit became due immediately. The period for appeal of the summary judgment expired on December 10, 2001. The Company has fully accrued for and established reserves for this judgment. The accrual is included in the letter of credit and promissory note on the face of the balance sheet.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

10. COMMITMENTS AND CONTINGENCIES

The Company leases office space under the terms of operating leases. The following chart shows lease obligations including rental of real property and equipment.

Year	Amount
-----	-----
2002	\$1,212,000
2003	1,129,000
2004	957,000
2005	917,000
2006	823,000
Thereafter	552,000

Total	\$5,590,000
	=====

Total rent expense under operating leases, including space rental, totaled approximately \$1,433,057 and \$79,646 for the years ended December 31, 2001 and 2000. The Company has total non-cancelable leases of \$2,446,177, included above, of which the Company has entered into sublease agreements with payments aggregating \$117,048 for the year ending December 31, 2002 and \$48,000 in each of the years ending December 31, 2003 through 2006.

In lieu of a security deposit, the Company has obtained a letter-of-credit from a commercial bank which is collateralized by a restricted cash deposit.

From time to time the Company is a party to various lawsuits that have arisen in the ordinary course of business. The amounts asserted in these matters are material to the Company's financial statements. While any litigation contains an element of uncertainty and although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, management believes that such losses, if any, will not have a material adverse effect on our the results of operations or financial position. However, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

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vFinance, Inc.

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Notes to Consolidated Financial Statements (continued)

December 31, 2001

10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On or about May 17, 2001, Golden filed an initial complaint against the Company in the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, alleging that the Company breached its January 5, 2001 employment agreement with Golden, which was entered into as a result of the merger between Colonial and the Company. Mr. Golden claims that he terminated the agreement for "good reason," as defined in the agreement, and that the Company failed to pay him severance payments and other benefits as well as accrued commissions and un-reimbursed expenses. In the initial complaint, Golden sought monetary damages from the Company in excess of \$50,000 including interest, attorney's fees and costs.

On or about July 18, 2001, the Company filed an answer and affirmative defenses and counterclaims with the Circuit Court against Golden and Ben Lichtenberg ("Lichtenberg"), Golden's partner in Colonial, denying all material allegations in the complaint, affirmatively alleging that Golden is not entitled to any severance payments because he was terminated for cause for insubordination, failure to follow directives of the board of directors and for breaches of fiduciary duty. The Company also alleged that both Golden and Lichtenberg violated the merger agreement between Colonial and the Company by breaching certain of the representations and warranties set forth in the merger agreement by, among other things, failing to advise the Company of certain loan agreement defaults, improperly withdrawing approximately \$400,000 of capital from Colonial, failing to deliver a closing balance sheet and failing to disclose significant liabilities of Colonial. The Company believes the activities of Golden and Lichtenberg constituted violations of Florida's Securities Investor Protection Act, common law fraud, breach of fiduciary duty, breach of contract, intentional interference with advantageous business relationships, and breach of the implied covenant of good faith and dealing, and the Company is seeking indemnification under the merger agreement and additional monetary damages against Golden and Lichtenberg in excess of \$15,000.

In response to the Company's answer, affirmative defenses and counterclaims, on or about September 1, 2001, Golden filed an amended complaint with the Court against the Company and its Primary Shareholders. In the amended complaint, Golden alleges the Primary Shareholders made various false representations that induced Golden to enter into the merger agreement and his employment agreement. Golden is seeking monetary damages from the Company and the Primary Shareholders in excess of \$4.6 million.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Lichtenberg filed an answer, affirmative defenses and counterclaims with the Court in response to the Company's filing with the Court on July 13, 2001. In

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addition to denying all material allegations in the Company's July 13, 2001 counterclaims against him, Lichtenberg alleges that: (a) the Company breached its employment agreement with him, (b) the Chief Executive Officer and Vice-Chairman and the Company made various false representations that induced Lichtenberg to enter into the merger agreement and (c) the Company materially breached the Colonial merger agreement. Lichtenberg is seeking delivery from the Company of 414,825 shares of the Company's common stock and monetary damages of at least \$488,000 from the Chief Executive Officer and Vice-Chairman and the Company, jointly and severally. On November 20, 2001, the Chief Executive Officer and Vice-Chairman and the Company filed an answer and affirmative defenses to these allegations denying Lichtenberg's allegations. The parties are proceeding with discovery and the matter has been placed on the Circuit Court's September 2002 trial docket. As the Company intends to vigorously defend itself and believes it has meritorious defenses against these claims, no amounts have been accrued.

First Colonial Securities Group, Inc. ("First Colonial") was subject to supervision and regulation by the NASD, the SEC and various state securities commissions. As part of this regulatory oversight, First Colonial was subject to periodic examination and inspections by these authorities. First Colonial was advised that as a result of an examination performed by the Philadelphia office of the NASD for the years 1996 and 1997, the NASD identified several possible material deficiencies. The NASD and the Company settled the matter in February 2002 with the Company paying a \$75,000 fine. Such fine was accrued in accounts payable at December 31, 2001.

On May 15, 2001, Louis D'Alessio filed a claim with the NASD against First Colonial and one of its employees. His claim alleges compensatory damages in an amount between \$100,000 and \$500,000 plus unspecified punitive damages. He alleges unfair business practices, violation of the federal securities act, violation of state securities statutes and common law fraud. The Company believes that the claim is without merit and is vigorously defending itself; however, the Company anticipates that the outcome will result in settlement. Thus, \$15,000, the Company's estimate of the amount of the settlement, is accrued as of December 31, 2001.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

10. COMMITMENTS AND CONTINGENCIES (CONTINUED)

On January 22, 2001, Josephine and Frank Oliveri filed a claim with the NASD against First Colonial and one of its employees. Their claim alleges compensatory damages of \$192,287 plus interest and punitive damages of \$100,000. They allege unsuitable investments, unauthorized trading, excessive trading and lack of supervision. The Company believes that the claim is without merit and is vigorously defending itself; however, the Company anticipates that the outcome will result in settlement. Thus, \$25,000, the Company's estimate of the amount of the ultimate settlement, is accrued as of December 31, 2001.

On October 3, 2001, Sterling Financial Investment Group filed a claim with the NASD against the Company and several of its employees. Their claim alleges

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compensatory damages and punitive damages to not exceed the sum of \$500,000. They alleged the Company offered and made significant cash payments to certain of Sterling's employees, to entice them to break their written employment agreements with Sterling and work for the Company. The Company believes that the claim is without merit and is vigorously defending itself; thus, no amounts have been accrued.

On August 14, 2001, Rosario Catanzarite, Joann Catanzarite, Anna Piegaro, Brian Catanzarite and Dina Catanzarite filed a claim with the NASD against First Colonial and several of its employees. Their claim alleges compensatory damages in the amount of \$125,000 plus interest. They allege that the employees abused their trust, processed unsuitable trades, coupled with abusive use of margin. The Company believes that the claim is without merit and is vigorously defending itself; however, the Company anticipates that the outcome will result in settlement. Thus, \$25,000, the Company's estimate of the amount of the ultimate settlement, is accrued as of December 31, 2001.

The Company is also engaged in a number of other legal proceedings incidental to the conduct of its business. Such claims aggregate a range of \$684,000 to \$1,919,000. In the opinion of management, the Company is adequately insured against the claims relating to such proceedings or has adequate resources to settle such claims, and any ultimate liability arising out of such proceedings will not have a material adverse effect on the financial condition or results of operations of the Company. The Company believes that the claims are without merit and is vigorously defending itself; however, the Company anticipates that the outcome of certain claims will result in certain settlements. Thus, \$112,000, the Company's estimate of the amount of the ultimate settlements, is accrued as of December 31, 2001.

An estimated loss from legal proceedings (loss contingency) as mentioned above has been accrued by a charge to income when both of the following conditions were met: (1) information was available prior to the issuance of the financial statements indicating that it is probable that a liability had been incurred at the date of the financial statements, and, (2) the amount of loss was reasonably estimated.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

December 31, 2001

11. DEFINED CONTRIBUTION PLAN

The Company maintains a defined contribution savings plan in which substantially all employees are eligible to participate. The Company may match up to 25% of the employee's salary. The Company made no contributions to the plan for the years ended December 31, 2001 and 2000, respectively.

12. SUBSEQUENT EVENT

On January 25, 2002, the Company entered into a Credit Agreement with UBS Americas, Inc. ("UBS"). Under the terms of the Credit Agreement, UBS will provide a revolving credit facility of \$3,000,000 to the Company for the purpose of supporting the expansion of its brokerage business or investments in infrastructure to expand its operations or its broker-dealer operations. The loan has a term of 4 years, must be repaid in full by January 2005 and bears

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interest at LIBOR plus a LIBOR margin of 2%. Among other covenants, the Company must maintain shareholder's equity of at least \$7,000,000; however, the Credit Agreement, as amended, specifically provides that the Company may exclude goodwill write-offs aggregating approximately \$8,500,000 from shareholder's equity. The Company is in compliance with all covenants as of the filing date and expects to remain in compliance throughout 2002. The Company must make early repayments under the Credit Agreement if it acquires a new broker dealer firm, enters a new line of business, or hires more than 4 brokers in a single or related transaction. This repayment is made by adding \$1.00 to the cost of each incremental clearing transaction the Company makes through CSC, a wholly owned subsidiary of Paine Webber which is a wholly owned subsidiary of UBS. The Company has not, to date, entered into a transaction that would trigger any repayment. The Company borrowed \$1,500,000 under the credit facility in January 2002. The Credit Agreement does not provide for conversion of the debt into equity securities.

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ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.

The following table sets forth the names, ages and positions of our executive officers and directors as of March 14, 2002. Under our bylaws, each director holds office until the election and qualification of his successor or until his earlier resignation or removal.

Name ----	Age ---	Position -----
Leonard J. Sokolow	45	Director, Chief Executive Officer and President
Timothy E. Mahoney	45	Director, Chief Operating Officer and Chairman
Wong Sin Just	36	Director
Robert F. Williamson, Jr.	57	Vice President and Chief Financial Officer
David A. Spector	36	Vice President
Richard Campanella	51	Secretary
Marc N. Siegel	42	President of vFinance Investments, Inc.

LEONARD J. SOKOLOW has been a director since November 8, 1997, our Chief Executive Officer since November 8, 1999, and our President since January 5, 2001. From November 8, 1999 through January 4, 2001, Mr. Sokolow was Vice Chairman of the Board. Since September 1996, Mr. Sokolow has been President of

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Union Atlantic LC, a merchant, banking and strategic consulting firm specializing domestically and internationally in technology industries that is a wholly owned subsidiary of our company. Since August 1993, Mr. Sokolow has been President of Genesis Partners, Inc., a private financial business-consulting firm. From August 1994 through December 1998, Mr. Sokolow was the Chairman and Chief Executive Officer of the Americas Growth Fund, Inc., a public closed-end management investment company. Mr. Sokolow presently serves as a director of Advanced Electronics Support Products, Inc., a worldwide distributor and manufacturer of active and passive networking components traded on Nasdaq. Mr. Sokolow received a B.A. degree with majors in Economics and Accounting from the University of Florida in 1977, a J.D. degree from the University of Florida School of Law in 1980 and an LL.M. (Taxation) degree from the New York University Graduate School of Law in 1982. Mr. Sokolow is a Certified Public Accountant.

TIMOTHY E. MAHONEY has been a director since November 8, 1999 and since November 8, 1999, Chairman of the Board and our Chief Operating Officer. Since September 1996, Mr. Mahoney has been a partner of Union Atlantic LC. From 1994 through 1995, Mr. Mahoney was President of the Highlands Group. Mr. Mahoney was a founder of the consumer products business for SyQuest Technology. In 1986, Mr. Mahoney founded and was the President of Rodime Systems,

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a computer disk drive sub-system manufacturer. In addition, Mr. Mahoney was the Vice President of Marketing and Sales for Tecmar, the first PC add-in board company and spent eight years in marketing and sales management in the computer timesharing business with Computer Sciences Corporation, Automatic Data Processing and General Electric Information Services. Mr. Mahoney presently serves as a director of FOCUS Enhancements, Inc., a developer and marketer of advanced, proprietary video scan conversion products traded on the Nasdaq SmallCap market. Mr. Mahoney received a B.A. degree with majors in Computer Science and Business from the West Virginia University in 1978. Mr. Mahoney received a Masters of Business Administration from George Washington University in 1983.

WONG SIN JUST has been a director since March 18, 2002. Mr. Wong was appointed as the Chief Executive Officer of E2-Capital (Holdings) limited ("E2-Capital") on 20th April 2000, was made Executive Co-Chairman and Acting Chief Executive Officer of E2-Capital on 3rd April 2001. Mr. Wong possesses over 11 years of investment banking and finance experience and has held positions with a number of premier international investment banks. From June 1996 to June 1998, Mr. Wong was the Director and Head of Greater China Equity Capital Markets at ABN AMRO Asia Corporate Finance Limited. Prior to establishing e2-Capital Limited (subsequently renamed as OpenIBN (HK) Limited), from June 1998 to October 1999, Mr. Wong was the Managing Director and the Head of Equity Capital Markets at BNP Prime Peregrine Securities Limited. Mr. Wong holds a Bachelor Degree in Engineering from Imperial College, University of London and is a member of the Association of Chartered Accountants, England and Wales. Mr. Wong is also an Executive Director and the Chief Executive Officer of Softbank Investment International (Strategic) Limited, an Independent Non-executive Director of hongkong.com Corporation and Capital Strategic Investment Limited.

ROBERT F. WILLIAMSON, JR. has been Chief Financial Officer and Vice President of our company since February 8, 2002. From November 1999 through November 2001, Mr. Williamson was Vice President, Finance and CFO of Equinox Systems Inc., which was acquired by Avocent Corporation in 2001. From 1985 through September

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1999, Mr. Williamson was Vice President, Finance and CFO of Data Net Corporation, which filed for Chapter 7 bankruptcy in November 1999.

DAVID A. SPECTOR has been a Vice President of our company since November 8, 1999. From 1995 through 1999, Mr. Spector served as Vice President and regional creative director of Green Advertising, a division of London-based WPP Group plc managing the creative efforts of the agency. Prior to that, Mr. Spector was a copywriter with Greenstone Roberts Advertising, with responsibilities for Royal Caribbean Cruise Lines and Radisson Hotels.

RICHARD CAMPANELLA has been Secretary of the Company since December 18, 2001. Mr. Campanella currently serves as director and Chief Operating Officer of vFinance Investments, Inc. From February 1994 until April 2001, Mr. Campanella was a partner of Commonwealth Associates, a registered broker dealer where he served as the Director of Compliance. He has a degree in Business Administration from the College of Staten Island.

MARC N. SIEGEL has been President and Chief Executive Officer of vFinance Investments since January 4, 2001. Mr. Siegel founded First Level Capital, Inc. in 1998 and served as its President

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for three years. We acquired First Level Capital, Inc. in 2001 and it now operates as vFinance Investments. From May 1997 until August 1998, Mr. Siegel was a partner of Grady & Hatch & Co., Inc., where he served as President and Managing Director. From September 1993 until June 1997, he was responsible for sales and marketing and recruiting, motivating and leading an 80-person sales force, which he directly supervised at Commonwealth Associates, a registered broker dealer. From September 1985 until 1993, Mr. Siegel was with Lehman Brothers, Inc., where he initially worked at Lehman's Atlanta office and served as its sales manager. Subsequently, from 1990 to 1992, he served as sales/manager of the Houston office and then became sales manager at Lehman Brothers' largest national office in New York. Mr. Siegel received a B.A. degree cum laude from Tulane University in 1981.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who beneficially own more than ten percent (10%) of a registered class of our company's equity securities, to file with the Securities and Exchange Commission (SEC) initial reports of ownership and reports of changes in ownership of Common Stock and the other equity securities of our company. Officers, directors and persons who beneficially own more than ten percent (10%) of a registered class of our company's equity securities are required by the regulations of the SEC to furnish our company with copies of all Section 16(a) forms they file.

To our knowledge, based solely on review of these filings and written representations from the directors and officers, there are no transactions during the fiscal year ended December 31, 2001 for which the officers, directors and significant stockholders have not timely filed the appropriate form under Section 16(a) of the Exchange Act, except that Messrs. Sokolow and Mahoney each filed one late Form 4 reporting one transaction each. In addition, Messrs. Sokolow and Mahoney each filed one late Form 4 reporting one transaction each for the fiscal year ended December 31, 2000 and Mr. Mahoney filed a late Form 3.

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ITEM 10. EXECUTIVE COMPENSATION.

The following table provides information concerning the annual and long term compensation earned by our chief executive officer and each of the four other most highly compensated executive officers of our company during the fiscal years ended December 31, 2001, 2000 and 1999:

SUMMARY COMPENSATION TABLE

Name/position -----	Year ----	Annual Salary -----	Bonus -----	Other Compensation -----
Leonard J. Sokolow CEO, President (1) (2) (3)	2001	\$169,500	\$150,000	\$7,289
	2000	\$150,000	\$120,000	\$12,000
	1999	\$24,200	\$ 5,600	\$2,000
Timothy E. Mahoney COO, Chairman (1) (2) (3)	2001	\$169,500	\$150,000	\$7,289
	2000	\$150,000	\$120,000	\$12,000
	1999	\$24,200	\$ 5,600	\$2,000
Marc Siegel President, vFinance Investments, Inc.	2001	\$120,000		\$92,000
	2000	0	0	0
	1999	0	0	0

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Richard Campanella Chief Operating Officer vFinance Investments, Inc.	2001	\$125,000	0	0
	2000	0	0	0
	1999	0	0	0
David Spector Vice President	2001	\$100,000	0	\$1,902
	2000	\$100,000	0	\$3,180

(1) From October 1993 through November 1999, Leonard J. Sokolow rendered supervisory and management services to us on behalf of our Managing Agent,

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Genesis Partners, Inc. In this capacity, Mr. Sokolow did not receive any cash compensation as noted in the table below but did receive 1,815 shares of common stock. Also, Genesis Partners, Inc. was issued a total of 348,185 shares of common stock in consideration for serving as our managing agent. Mr. Sokolow is President and CEO and a controlling shareholder of Genesis Partners, Inc.

(2) Messrs. Sokolow and Mahoney each received \$120,000 of annual incentive compensation based on the performance of our company and our subsidiaries during 2000 which are reflected in the table below as bonuses.

(3) Messrs. Sokolow and Mahoney each received a \$12,000 car allowance during 2000 which are reflected in the table above as other annual compensation.

(4) Cancellation in January 2001 and reissuance in July 2001.

OPTION GRANTS IN LAST FISCAL YEAR

The following table provides information with respect to the chief executive officer and each of the other named executive officers listed in the Summary Compensation Table concerning stock options granted on our common stock in fiscal year 2001:

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise or Base Price (\$/Share)	Expiration
Leonard Sokolow	734,802	11.3%	\$0.35 - \$0.625	August 30,
Timothy Mahoney	734,802	11.3%	\$0.35 - \$0.625	August 30,
Marc Siegel	565,000	8.7%	\$0.35 - \$0.625	August 30,
Richard Campanella	100,000	1.5%	\$0.35 - \$0.625	August 30,
David Spector	25,000	0.4%	\$0.35 - \$0.625	August 30,

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AGGREGATED OPEN EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END VALUES

The following table provides information regarding stock option exercises during 2001 by the chief executive officer and each of the other named executive officers listed in the Summary Compensation Table:

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Name	Number of Securities		Underlying Unexercisable Options at Fiscal Year-End		Value of Unexe Options at
	Shares Acquired on Exercise	Value Realized	Exercisable	Unexercisable	Exercisable
Leonard Sokolow	0	0	359,802	375,000	\$ 0
Timothy Mahoney	0	0	359,802	375,000	\$ 0
Marc Siegel	0	0	215,000	350,000	\$ 0
Richard Campanella	0	0	0	100,000	\$ 0
David Spector	0	0	286,000	39,000	\$ 0

COMPENSATION OF DIRECTORS

Directors do not receive any compensation for serving on our Board of Directors.

EMPLOYMENT AGREEMENTS

On January 5, 2001, we entered into a three-year employment agreement, as subsequently amended, with each of Mr. Sokolow, our Chief Executive Officer and President, and Mr. Mahoney, our Chairman. Under the terms of these agreements, which are automatically extended unless we have provided a non-renewal notice as directed by a majority vote of the board of directors, each of Messrs. Sokolow and Mahoney are entitled to receive:

o An initial base salary of \$208,000 per annum for the first year with a 5% increase per annum beginning oze="2">0.0

\$
3.4

\$
5.7

\$
3.3

\$
3.3

\$
5.7

\$
9.0

\$
3.4

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\$
77.4

Cash Interest Payments

10.9

8.8

0.3

0.1

0.1

7.0

5.9

2.3

1.5

1.4

6.2

1.4

45.9

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Operating Lease Payments

82.5

8.1

8.3

7.3

6.6

9.0

29.4

9.9

13.1

9.5

57.6

9.5

250.7

Total

\$
133.4

\$
18.4

\$
8.6

\$
9.7

\$
6.7

\$
19.4

\$
41.0

\$
15.5

\$
17.9

\$
16.6

\$
72.7

\$
14.3

\$
374.0

Debt Service and Lease Payment Reduction

Jan-03

Feb-03

Mar-03

Apr-03

May-03

Jun-03

Jul-03

Aug-03

Sep-03

Oct-03

Nov-03

Dec-03

2003

Principal Payments

\$
0.0

\$
0.0

\$
1.1

\$
15.2

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\$
4.1

(\$2.3
)

\$
15.2

\$
1.4

(\$2.1
)

\$
13.4

(\$4.3
)

(\$0.5
)

\$
41.2

Cash Interest Payments

(0.2
)

(1.2
)

0.3

10.1

7.1

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(6.3
)

3.9

5.3

(0.9
)

8.7

1.0

(0.9
)

26.9

Operating Lease Payments

10.9

1.5

1.3

14.4

3.1

0.6

20.1

9.0

(3.6
)

(0.1
)

(48.2
)

0.8

9.8

Total

\$
10.7

\$
0.3

\$
2.8

\$
39.7

\$
14.3

(\$8.0
)

\$
39.2

\$
15.7

(\$6.6
)

\$
22.0

(\$51.6
)

(\$0.6
)

\$
78.0

2004 2007 Quarterly Pre-Restructured and Pro Forma Debt and Lease Payment Schedules

(\$ in millions)

Pre-Restructured Debt Service and Lease Payment Summary

	<u>Q1-04</u>	<u>Q2-04</u>	<u>Q3-04</u>	<u>Q4-04</u>	<u>2004</u>	<u>Q1-05</u>	<u>Q2-05</u>	<u>Q3-05</u>	<u>Q4-05</u>	<u>2005</u>
Principal Payments	\$ 31.3	\$24.4	\$ 26.8	\$24.3	\$106.8	\$28.5	\$15.0	\$148.3	\$ 8.8	\$200.6
Cash Interest Payments	16.8	17.1	15.9	16.3	66.2	15.1	15.6	14.2	15.2	60.0
Operating Lease Payments	118.2	44.9	62.2	27.2	252.5	121.8	44.9	59.4	23.9	249.9
Total	\$166.4	\$86.3	\$104.9	\$67.8	\$425.5	\$165.3	\$75.5	\$221.9	\$47.8	\$510.5

Pro Forma Debt Service and Lease Payment Summary

	<u>Q1-04</u>	<u>Q2-04</u>	<u>Q3-04</u>	<u>Q4-04</u>	<u>2004</u>	<u>Q1-05</u>	<u>Q2-05</u>	<u>Q3-05</u>	<u>Q4-05</u>	<u>2005</u>
Principal Payments	\$11.9	\$13.0	\$13.2	\$13.3	\$ 51.4	\$13.7	\$14.0	\$14.2	\$15.2	\$ 57.2
Cash Interest Payments	5.3	5.9	5.7	5.4	22.3	5.6	5.4	5.1	4.8	21.0
Operating Lease Payments	41.4	48.6	48.6	48.6	187.2	51.1	51.1	51.1	59.2	212.5
Total	\$58.6	\$67.5	\$67.5	\$67.4	\$260.9	\$70.4	\$70.5	\$70.5	\$79.2	\$290.7

Debt Service and Lease Payment Reduction

	<u>Q1-04</u>	<u>Q2-04</u>	<u>Q3-04</u>	<u>Q4-04</u>	<u>2004</u>	<u>Q1-05</u>	<u>Q2-05</u>	<u>Q3-05</u>	<u>Q4-05</u>	<u>2005</u>
Principal Payments	\$ 19.4	\$11.4	\$13.6	\$ 11.0	\$ 55.4	\$14.7	\$ 1.1	\$134.1	(\$6.5)	\$143.4
Cash Interest Payments	11.5	11.2	10.2	10.9	43.8	9.5	10.1	9.1	10.4	39.1
Operating Lease Payments	76.9	(3.8)	13.6	(21.4)	65.3	70.7	(6.3)	8.3	(35.3)	37.4
Total	\$107.8	\$18.9	\$37.4	\$ 0.5	\$164.6	\$94.9	\$ 4.9	\$151.4	(\$31.4)	\$219.8

Table of Contents**2004 2007 Quarterly Pre-Restructured and Pro Forma Debt and Lease Payment Schedules (Cont d)****Pre-Restructured Debt Service and Lease Payment Summary**

	Q1-06	Q2-06	Q3-06	Q4-06	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Principal Payments	\$ 14.8	\$36.4	\$ 4.4	\$149.6	\$205.3	\$ 6.7	\$ 1.2	\$ 3.1	\$ 1.3	\$ 12.4
Cash Interest Payments	6.4	14.9	5.4	14.2	40.9	5.2	7.2	5.0	7.2	24.6
Operating Lease Payments	114.3	40.6	55.4	19.8	230.1	110.2	40.7	53.4	17.0	221.2
Total	\$135.6	\$91.9	\$65.2	\$183.5	\$476.2	\$122.1	\$49.1	\$61.5	\$25.4	\$258.2

Pro Forma Debt Service and Lease Payment Summary

	Q1-06	Q2-06	Q3-06	Q4-06	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Principal Payments	\$13.5	\$13.5	\$13.8	\$14.0	\$ 54.8	\$14.3	\$14.6	\$14.9	\$15.2	\$ 59.1
Cash Interest Payments	4.4	4.1	3.8	3.6	15.9	3.4	3.1	2.9	2.5	11.8
Operating Lease Payments	48.6	48.6	48.6	48.2	194.1	48.6	48.6	48.6	48.6	194.5
Total	\$66.5	\$66.2	\$66.2	\$65.9	\$264.8	\$66.3	\$66.4	\$66.4	\$66.3	\$265.4

Debt Service and Lease Payment Reduction

	Q1-06	Q2-06	Q3-06	Q4-06	2006	Q1-07	Q2-07	Q3-07	Q4-07	2007
Principal Payments	\$ 1.3	\$22.9	(\$9.4)	\$135.6	\$150.4	(\$7.6)	(\$13.4)	(\$11.8)	(\$13.9)	(\$46.7)
Cash Interest Payments	2.1	10.8	1.6	10.6	25.0	1.9	4.1	2.1	4.7	12.8
Operating Lease Payments	65.7	(8.0)	6.8	(28.5)	36.0	61.6	(7.9)	4.8	(31.7)	26.8
Total	\$69.1	\$25.7	(\$1.0)	\$117.6	\$211.4	\$ 55.8	(\$17.2)	(\$4.9)	(\$40.9)	(\$7.2)

The assumed post-reorganization capital structure reflects the current status of negotiations with the Company's various creditor constituencies. Although some of the capital structure assumptions are based on signed term sheets, others are based on draft term sheets and discussions with the Company's creditor groups as of September 4, 2003. The 2003-2007 Projected Pro Forma Summary Financial Statements and underlying assumptions were prepared by management and reflect management's judgment as of September 4, 2003, of expected future operating conditions affecting the Company and management's expected course of action. There may be differences between the projected and actual results because events and circumstances, including the final agreements of the creditors and lessors regarding the restructuring concessions, may not occur as expected. Those differences may be material and adverse.

The 2003-2007 Projected Pro Forma Summary Financial Statements are based on a number of estimates and assumptions that, although considered reasonable by management, are inherently subject to significant economic and competitive uncertainties and contingencies beyond the control of the Company and management and upon assumptions with respect to future business decisions which are subject to change. Accordingly, there can be no assurance that the projected results will be realized, and actual results may vary materially from those projected. If actual results are lower than those shown, or if the assumptions used in formulating the projections are not realized, Company cash flows could be materially and adversely affected.

These projections assume that no material claims will arise that will require a cash settlement. The Company's balance sheet has not been adjusted for Fresh Start accounting as determined by Statement of Position 90 - 7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code. If the restructuring were implemented through a Chapter 11 filing, Fresh Start accounting could have a material impact on the Company's balance sheet.

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In the normal course of operating and managing the Company, management may revise the projections to reflect changes in assumptions, particularly as they relate to confirming a plan of reorganization. Management assumes no responsibility to advise users of the projections about any subsequent changes thereto.

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Use of Non-GAAP Financial Measures

This Current Report on Form 8-K contains non-GAAP financial measures as part of the 2003-2007 Projected Pro Forma Summary Financial Statements. Generally, a non-GAAP measure is a numerical measure of a company's historical or future financial performance, financial position, or cash flows that either excludes or includes amounts that are not normally excluded or included in the most directly comparable measure calculated and presented in accordance with accounting principles generally accepted in the United States (GAAP). Pursuant to the requirements as defined in SEC Regulation G, the Company has provided below quantitative reconciliations within this Current Report on Form 8-K of the non-GAAP financial measures to the most comparable GAAP financial measures.

The Company has included earnings before interest, taxes, depreciation and amortization (EBITDA) and earnings before interest, taxes, depreciation and amortization and aircraft rentals (EBITDAR) as part of the 2003-2007 Projected Pro Forma Summary Financial Statements, which are non-GAAP financial measures as defined in SEC Regulation G. EBITDA and EBITDAR are not measures of financial performance or liquidity under GAAP but are commonly used in the airline industry to gauge a company's ability to meet debt service and lease payment requirements. Accordingly, these measures should not be considered as substitutes for net income, income from operations, net cash provided by operating activities, total indebtedness or any other operating, liquidity, indebtedness or capitalization measure prepared in accordance with GAAP. Items excluded from EBITDA and EBITDAR are significant components in understanding and assessing our financial performance. As part of our Current Report on Form 8-K, we have provided a reconciliation of EBITDA and EBITDAR to cash provided by or used for operating activities, which is the nearest comparable GAAP financial measure. However, because EBITDA and EBITDAR are not based on any standardized methodology prescribed by GAAP, investors should note that they are not necessarily comparable to similar measures presented by other companies.

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The following table reconciles net cash provided by/(used for) operating activities to EBITDA and EBITDAR for the periods presented (in thousands):

	For the years ended				
	2003	2004	2005	2006	2007
Net cash (used for) provided by operating activities	\$ (83.9)	\$ 101.9	\$ 85.1	\$ 120.5	\$ 151.9
Add (deduct):					
Interest Income	(3.1)	(0.8)	(1.1)	(1.3)	(1.8)
Interest Expense	60.3	26.7	23.3	19.6	15.8
Restructuring and non-recurring charges	35.2	21.5			
Income Tax expense		9.5	31.5	46.1	53.7
Changes in operating assets and liabilities, net of accrued interest, rent and restructuring accruals:					
Accounts receivable	(0.9)	14.2	13.7	14.0	3.3
Prepaid expenses and other assets	(9.6)	(30.3)	(18.1)	(15.8)	(28.2)
Accounts payable and accrued liabilities	100.9	(45.3)	1.6	(9.2)	(3.0)
Other liabilities	30.0	15.8	15.6	15.5	15.6
EBITDA	128.9	113.2	151.6	189.4	207.3
Aircraft rent	188.8	182.5	182.5	182.1	181.8
EBITDAR	\$ 317.7	\$ 295.7	\$ 334.1	\$ 371.5	\$ 389.1

Financial Information**Consolidated Unaudited Financial Data for the year ended December 31, 2002, the three months ended March 31, 2003 and June 30, 2003 and the six months ended June 30, 2003.**

The following consolidated financial statements and data of the Company, Atlas and Polar were prepared by management for their internal use and are unaudited and subject to change. All significant intercompany accounts and transactions have been eliminated in consolidation. The 2002 and 2003 financial statements reflect a change in the method of accounting for heavy maintenance expenses (except certain engine overhaul costs) from the accrual and deferral methods to direct expense. The financial statements do not include the footnote disclosure necessary to be in compliance with GAAP. The financial statements reflect the impact of all adjustments made as a result of the Company's restatement of its December 31, 2001 balance sheet to incorporate adjustments to retained earnings relating to periods prior to the 2002 fiscal year comprised primarily of (i) impairment charges to aircraft and related equipment held for use, (ii) correction of the previous accounting for heavy maintenance expense, (iii) inventory obsolescence, and (iv) an increase in allowance for doubtful accounts. The net effect of such restatement was to reduce Retained Earnings at December 31, 2001, as previously reported in the Company's 2001 financial statements audited by Arthur Andersen LLP, from \$185.1 million to an Accumulated Deficit of (\$178.7) million. Although the 2002 audit is substantially complete, the unaudited consolidated financials for 2002 remain subject to change until the audit is completed. The Company anticipates that its current auditors, Ernst & Young LLP (E&Y), will complete its audit at and for the year ended December 31, 2002 by the end of September 2003. The Company does not expect that E&Y will be able to complete the Company's previously-announced attempt to restate its 2000 and 2001 financial statements due to the Company's inability to locate certain financial records from those periods. As a result, we are not in compliance with various accounting and disclosure requirements contained in the Securities Exchange Act of 1934. Due, in part, to our failure to comply with such requirements, the New York Stock Exchange has suspended trading of our common stock and has initiated steps to delist the common stock from the Exchange. It is not possible to predict fully the effects of such a suspension and delisting on the trading price and liquidity for the common stock.

The accompanying unaudited consolidated financial statements have been prepared with the assumption that the Company will continue as a going concern, which contemplates continuity of operations, realization of assets and satisfaction of liabilities in the ordinary course of business. The Company's ability to continue as a going concern is dependent on its ability to generate sufficient cash flows to meet obligations on a timely basis, to negotiate new

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agreements with its aircraft lessors and debt providers, and to obtain additional financing should industry conditions not improve. The uncertainties relating to the Company's restructuring efforts raise substantial doubt at December 31, 2002 about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of the carrying amount of recorded assets or the amount and classification of liabilities, other than a reclassification of its long-term debt as a current liability, that might result should the Company be unable to continue as a going concern. Nor do the financial statements make any provision for any additional costs or losses (including impairments) which may be incurred in connection with the possible return of leased or financed aircraft or the costs and other matters associated with the contemplated Chapter 11 filing.

Table of Contents**A. Consolidated Unaudited Financial Statements of Atlas Air Worldwide Holdings, Inc. for the year ended December 31, 2002.**

Atlas Air Worldwide Holdings, Inc.
Consolidated Statement of Operations (000s)*
For the Year Ended December 31, 2002
(UNAUDITED)

Charter Service	\$ 376,373
ACMI Lease Contracts	358,077
Scheduled Service	347,778
Other Income	108,552
	<hr/>
Total Operating Revenue	1,190,780
Salaries, Wages and Benefits	189,382
Maintenance Materials and Repairs	215,972
Aircraft Fuel	215,185
Aircraft Rent	212,774
Ground Handling	64,809
Landing Fees and Other Rent	64,244
Travel	49,566
Depreciation	50,209
Impairment Loss	7,850
Other	129,575
	<hr/>
Total Operating Expense	1,199,566
Operating Loss	(8,786)
Interest Income	(10,335)
Interest Expense	80,502
Other	1,615
	<hr/>
Total non-operating expenses	71,782
Loss before Taxes and Cumulative Effect of Accounting Change	(80,568)
Income Taxes	
	<hr/>
Loss before Cumulative Effect of Accounting Change	(80,568)
Cumulative Effect of Accounting Change	44,556
	<hr/>
Net Loss	\$ (36,012)
	<hr/>

*Financial information subject to change

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Atlas Air Worldwide Holdings, Inc.
Consolidated Balance Sheet (000s) *
December 31, 2002
(UNAUDITED)

Cash and Cash Equivalents	\$ 222,881
Short-Term Investments	30,967
Accounts Receivable, net	228,676
Prepaid Expenses	174,445
Inventory	11,573
	<hr/>
Total Current Assets	668,542
Flight Equipment	767,087
Ground Equipment	59,436
Accumulated Depreciation	(108,667)
	<hr/>
Property, Plant and Equipment, net	717,856
Route Acquisition Costs	56,071
Deposits and Other Assets	80,286
Loan Fees, net	56,704
	<hr/>
Total Assets	\$ 1,579,459
	<hr/>
Accounts Payable and Accrued Liabilities	\$ 295,200
Current Portion of Long Term Debt	930,642
	<hr/>
Total Current Liabilities	1,225,842
Other Liabilities and Deferred Gains	262,819
Preferred stock, \$1 par value; 10,000,000 shares authorized; no shares issued	
Common stock, \$0.01 par value; 50,000,000 shares authorized; 38,320,033 shares issued	383
Treasury stock at cost; 48,057 shares	(135)
Additional Paid in Capital	305,210
Accumulated Deficit	(214,698)
Accumulated other comprehensive loss	38
	<hr/>
Stockholders Equity	90,798
	<hr/>
Total Liabilities & Stockholders Equity	\$ 1,579,459
	<hr/>

*Financial information subject to change

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Atlas Air Worldwide Holdings, Inc.
Consolidated Statement of Cash Flows (000s) *
For the Year Ended December 31, 2002
(UNAUDITED)

Cash Flow from Operating Activities:	
Net Loss	\$ (36,012)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation	50,209
Common stock issued as compensation	600
Recognition of compensation from Restricted Stock Units	452
Provision for doubtful accounts	16,349
Cumulative effect of accounting change	(44,555)
Amortization of debt issuance cost and lease financing deferred gains	(10,240)
Impairment loss	7,850
Other, net	463
Changes in operating assets and liabilities:	
Accounts receivable and other	(29,095)
Inventory	(21,466)
Prepays and other current assets	(57,944)
Deposits and other assets	11,211
Accounts payable and accrued liabilities	158,355
	<hr/>
Net cash provided by operating activities	46,177
Cash Flow from Investing Activities:	
Capital expenditures	(39,826)
Purchase of investments	(145,257)
Proceeds from liquidation of investments	226,483
	<hr/>
Net cash provided by investing activities	41,400
Cash Flow from Financing Activities	
Proceeds from sale leaseback transactions	14,337
Proceeds from issuance of common stock	1,023
Purchase of treasury stock	(1,076)
Payments on long-term debt and capital lease obligations	(94,344)
Debt issuance costs and deferred lease costs	(19,121)
	<hr/>
Net cash used for financing activities	(99,181)
	<hr/>
Net increase in cash	(11,604)
Cash at the beginning of period	234,485
	<hr/>
Cash at end of period	\$ 222,881
	<hr/>

*Financial information subject to change

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Atlas Air, Inc. and Polar Air Cargo, Inc.
Select Financial Data (000s) *
As at and for the year ended December 31, 2002
(UNAUDITED)

Atlas Air, Inc.

Operating Revenue	\$716,517
Aircraft Rent	131,118
Depreciation	39,552
Other Operating Expense	550,257
	<hr/>
Operating Expense	720,927
Operating Loss	\$ (4,410)
	<hr/>
Capital Expenditures	\$ 47,393
	<hr/>
Cash, Cash Equivalents and Short-Term Investments	\$ 227,157
	<hr/>

Polar Air Cargo, Inc.

Operating Revenue	\$527,556
Aircraft Rent	124,802
Depreciation	10,657
Other Operating Expense	391,984
	<hr/>
Operating Expense	527,443
Operating Income	\$ 113
	<hr/>
Capital Expenditures	\$ 12,239
	<hr/>
Cash, Cash Equivalents and Short-Term Investments	\$ 20,686
	<hr/>

*Selected Financial Data subject to change

Table of Contents**B. Lease and Debt Obligations and Contingencies as of December 31, 2002.****Debt and Capital Lease Obligations**

We are currently in default with respect to our reporting covenants and payment obligations under certain of our aircraft-related lease and debt agreements, which, as a result, are classified as a current liability at December 31, 2002.

Debt and capital lease obligations as of December 31, 2002 are as follows (in thousands):

AFL III Term Loan Facility	\$ 194,893
Aircraft Credit Facility	50,607
10 3/4% Senior Notes due 2005	137,475
9 1/4% Senior Notes due 2008	152,869
9 3/8% Senior Notes due 2006	147,000
1998 EETC s	84,358
1999 EETC s	91,990
GECAS Term Loan	9,320
Other	62,130
	\$ 930,642

Commitments and Contingencies*Aircraft/Real Estate Leases*

At December 31, 2002, minimum annual rental commitments under capital leases and noncancelable aircraft operating leases with initial or remaining terms of more than one year are as follows (in thousands):

	Aircraft Leases	
	Capital	Operating
Years Ending December 31,		
2003	\$ 2,815	\$ 260,529
2004	1,394	252,543
2005		249,922
2006		230,054
2007		221,113
Thereafter		2,515,751
Total minimum lease payments	4,209	\$ 3,729,912
Less amounts representing interest	(83)	
Present value of future minimum capital lease payments	4,126	
Less current obligations under capital lease	(2,815)	
Long-term obligations under capital lease	\$ 1,311	

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In addition to the above commitments, the Company leases engines under short-term lease agreements on an as needed basis.

Aircraft and engine rent expense, including short-term rent, were \$211.9 million for the year ended December 31, 2002.

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Real estate rent expenses were \$10.6 million for the year ended December 31, 2002.

Aircraft Purchase Commitments

Under the terms of the Boeing Purchase Agreement, one remaining Boeing 747-400 freighter aircraft (the aircraft) was to be delivered October 2003. In February 2003, Atlas and Boeing reached a Supplemental Agreement (the Agreement) to move the aircraft delivery date to October 2006. As part of the Agreement, of the \$3.4 million Atlas had paid as of December 31, 2002 as purchase deposits on this aircraft, approximately \$2.9 million will be applied as a slide fee for the deferring of delivery of the aircraft to October 2006. The remaining \$0.5 million will be applied to a new Deferred Advance Payment Schedule on the aircraft. The following table details the revised advance payment schedule (in thousands):

	Deferred Advance Payment Amount
Upon Signing of Supplemental Agreement	\$ 500.0
September 1, 2004	1,648.4
June 1, 2005	10,742.1
September 1, 2005	8,593.6
December 1, 2005	6,445.2
	<hr/>
Total	\$27,929.3

Interest on the Deferred Amount will commence on September 1, 2004, and will be charged at the fluctuating rate of interest per annum equal to the six month London Interbank Offered Rate (LIBOR) as published in the Wall Street Journal effective for the first business day of each calendar quarter, plus three percent.

The inability to secure financing for the 2006 aircraft delivery could result in a default under the Boeing Purchase Agreement, which could permit Boeing to accelerate payments due under the Boeing Purchase Agreement. Such acceleration could cause a default in covenants of certain of our indebtedness which could permit the lenders to accelerate payment of a significant portion of all indebtedness, which event would have a material adverse effect on our financial position and results of operations. The Company is in discussions with Boeing about further deferrals of the aircraft delivery date or additional modifications to this commitment.

The Company has no obligations or commitments with respect to additional new aircraft deliveries beyond that noted above.

With respect to the December 2002 aircraft delivery, Atlas secured an operating lease financing arrangement with General Electric Capital Aviation Services (GECAS). In connection with the delivery, \$6.0 million in previously paid aircraft deposits were returned to Atlas during the fourth quarter of 2002.

Labor

The Airline Pilots Association (ALPA) represents all of our U.S. Pilots. Collectively, these employees represent approximately 55% of our workforce as of December 31, 2002. Polar's collective bargaining agreement with ALPA became amendable in May 2003, subject to ratification, and we cannot accurately predict the outcome of any negotiations. Although we have never had a work interruption or stoppage and believe our relations with our Pilots are generally good, we are subject to risks of work interruption or stoppage and/or may incur additional administrative expenses associated with union representation of our employees. If we are unable to reach an agreement with our Pilots on the terms of their collective bargaining agreements, or if Atlas Air was unable to negotiate future contracts with our Pilots, we may be subject to work interruptions and/or stoppages. Any sustained work stoppages could adversely affect our ability to fulfill our obligations under ACMI lease contracts and other agreements and could have a material, adverse effect on our financial condition and results of operations. Copies of the collective bargaining agreements have been posted on the Company's website.

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Legal Proceedings

Existing and Potential Claims Against the Company for Alleged Violation of the Securities Laws

The Company and several of its current and former officers and directors have been named as defendants in seven putative class action complaints filed in the United States District Court for the Southern District of New York. The seven class actions were filed on behalf of purchasers of the Company's publicly traded common stock during the period April 18, 2000 through October 15, 2002, inclusive (the Class Period) and allege, among other things, that during the Class Period the Company and the individual defendants knowingly issued materially false and misleading statements to the market throughout the Class Period in violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the Exchange Act). Two of the class actions also include claims under the Securities Act of 1933 (Securities Act) on behalf of purchasers of common stock pursuant or traceable to the May 15, 2000 and September 18, 2000 prospectus supplements issued by the Company. The Securities Act claims are alleged only against a named former director and the lead underwriter of the May and September 2000 offerings. The complaints seek unspecified compensatory damages and other relief. The Company expects to respond to the plaintiffs consolidated Amended Complaint and to provide a vigorous defense to the litigation. On May 19, 2003, a senior judge of the Southern District of New York issued an order consolidating the seven class actions.

On October 25, 2002 and November 12, 2002, two shareholder derivative complaints were filed on behalf of the Company against the members of the Company's Board of Directors in the Supreme Court of New York, Westchester, County. Both actions charge that the defendants violated (1) their fiduciary duties of loyalty and good faith, (2) Generally Accepted Accounting Principles, (3) the Company's Audit Committee Charter by failing to implement and maintain an adequate internal accounting control system, and that a named director further breached their fiduciary duties of loyalty and good faith by using material non-public information to sell shares of the Company's common stock at artificially inflated prices. The Company is not aware of any prior demand for corporate action by either Plaintiff. The Company and the individual defendants in the derivative actions have entered into a stipulation with the derivative plaintiffs under which the derivative actions will be consolidated.

On October 17, 2002, Atlas received a letter from the Northeast Regional Office of the United States Securities and Exchange Commission informing it that an informal investigation had been commenced arising out of the Company's October 16, 2002 announcement that it would restate its financial results for 2000 and 2001. The SEC has since issued a Formal Order of Investigation and on January 21, 2003, served upon the Company a subpoena requiring the production of documents. The Company intends to continue cooperating fully with the SEC in its investigation.

Other Litigation

In the fourth quarter of 2002, Atlas and Malaysian Airlines reached an agreement to settle the arbitration proceedings between them and such settlement did not have a material adverse impact on the Company.

Pursuant to the terms of the collective bargaining agreement between Polar and ALPA, which represents Polar's crew members, disputes over contract interpretation can be filed as grievances and, if not satisfactorily resolved between the parties, are subject to arbitration. On January 30, 2002, ALPA filed a grievance claiming a pay raise was due in December 2001 to Polar crew members. Polar has disputed this claim, alleging that certain conditions precedent have not been met. The total amount at issue as to all Polar crewmembers is approximately \$324,000. The grievance was settled in May 2002 and the settlement provides for a 1.5 percent wage increase for the crewmembers retroactive to December 1, 2001.

Wells Fargo, which leased a Boeing 747 aircraft to Polar, has brought an action in the United Kingdom against Polar for its alleged failure to return the aircraft in compliance with return conditions as set forth in the lease. Wells Fargo is seeking monetary damages, including double rent and the cost of maintenance to restore the aircraft to comply with the specified return conditions. The Company disputes the allegations set forth in Wells Fargo's complaint and intends to defend this action vigorously.

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Miami-Dade County (the County) is currently investigating and remediating various environmental conditions at the Miami International Airport (MIA) and funding the remediation costs through landing fees and various cost recovery methods. The County initiated a lawsuit in 2001 against approximately 17 defendants and has identified another 243 potentially responsible parties (PRPs) in an attempt to recover its past and future costs relating to the investigation and remediation of soil and groundwater contamination at MIA. While the Company is not named in the lawsuit, it has been identified as a PRP. The Company's portion of the cleanup costs cannot be reasonably estimated due to a variety of factors, including the unknown extent and cost of the remedial actions required. However, given the proportion of the cost that will ultimately be recovered from other the PRPs who have had longer and more substantial operations at MIA, such costs are not expected to have a material adverse effect upon the Company.

On August 7, 2001, Atlas sued Southern Air, Inc. (Southern) and Hernan Galindo (Galindo) in Dade County Circuit Court seeking damages in excess of \$13 million alleging, among other things, that these defendants committed tortious interference with Atlas' contracts or advantageous business relationships with Aerofloral, Inc., unfair competition and conspiracy. Atlas subsequently filed a Second Amended Complaint joining additional defendants James K. Neff (Neff), Randall P. Fiorenza (Fiorenza), Jay Holdings LLC, and EFF Holdings LLC, on the same legal theories asserted against Southern and Galindo. On November 15, 2002, Southern filed a petition for relief under Chapter 11 of the U.S. Bankruptcy Code, and the action has been stayed against Southern. The court, however, denied the other defendants' motions to dismiss, and they have now answered the Second Amended Complaint denying any liability to Atlas.

Recently, Southern filed a motion for leave of court to file a counterclaim against Atlas and a third party complaint against the Company. The motion is scheduled for hearing on October 14, 2003. The proposed counterclaim and third party complaint allege, among other things, that Atlas and the Company are alter egos of each other and committed various torts against Southern, including tortious interference with contract and with advantageous business relationships, unfair competition, conspiracy, and other anti-competitive acts in violation of Florida law. The proposed counterclaim and third party complaint do not specify the damages sought by Southern other than the minimal jurisdictional amount of \$15,000. Atlas and the Company do not believe that the proposed counterclaim and third party complaint have any merit and intend to resist the motion for leave to file the pleading. They also intend to vigorously defend against the claims asserted if the court permits the pleading to be filed.

The Company is involved in other litigation in the ordinary course of business, and there are no other material legal proceedings pending against it or to which any of its property is subject.

Table of Contents**C. Consolidated Unaudited Financial Statements of Atlas Air Worldwide Holdings, Inc. for the three months ended March 31, 2003 and June 30, 2003 and for the six months ended June 30, 2003.**

Atlas Air Worldwide Holdings, Inc.
Consolidated Statement of Operations (000s) *
(UNAUDITED)

	Six Months Ended June 30, 2003	Three Months Ended June 30, 2003	Three Months Ended March 31, 2003
Charter Service	\$ 296,379	\$ 134,511	\$ 161,868
Scheduled Service	221,487	114,847	106,640
ACMI Lease Contracts	138,683	71,163	67,520
Other Income	22,884	6,052	16,832
	<u>679,433</u>	<u>326,573</u>	<u>352,860</u>
Total Operating Revenue	679,433	326,573	352,860
Salaries, W ages and Benefits	103,861	50,937	52,924
Maintenance Materials and Repairs	100,775	53,136	47,639
Aircraft Fuel	157,460	73,337	84,123
Aircraft Rent	97,062	45,946	51,116
Ground Handling	43,973	22,147	21,826
Landing Fees and Other Rent	46,134	24,455	21,679
Travel	29,434	13,469	15,965
Depreciation	35,977	21,524	14,453
Loss on Disposal of Fixed Assets	4,322	4,322	
Other	87,147	41,843	45,304
	<u>706,145</u>	<u>351,116</u>	<u>355,029</u>
Total Operating Expenses	706,145	351,116	355,029
Operating Loss	(26,712)	(24,543)	(2,169)
Interest Income	(2,162)	(1,154)	(1,008)
Interest Expense	38,850	19,702	19,148
Other	1,859	842	1,017
	<u>38,547</u>	<u>19,390</u>	<u>19,157</u>
Total Non-operating Expenses	38,547	19,390	19,157
Loss before Taxes	(65,259)	(43,933)	(21,326)
Income Tax Provision			
	<u>\$ (65,259)</u>	<u>\$ (43,933)</u>	<u>\$ (21,326)</u>
Net Loss	\$ (65,259)	\$ (43,933)	\$ (21,326)

*Financial information subject to change

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Atlas Air Worldwide Holdings, Inc.
Consolidated Balance Sheet (000s) *
(UNAUDITED)

	June 30, 2003	March 31, 2003
Cash and Cash Equivalents	\$ 142,729	\$ 139,589
Accounts Receivable, net	223,998	246,435
Prepaid Expenses	213,296	222,864
Inventory	8,613	10,997
Total Current Assets	588,636	619,886
Flight Equipment	743,777	762,709
Ground Equipment	59,642	59,620
Accumulated Depreciation	(125,219)	(117,479)
Property, Plant and Equipment, net	678,200	704,850
Route Acquisition Costs	56,071	56,071
Deposits and Other Assets	75,257	73,577
Loan Fees, net	53,755	55,416
Total Assets	\$1,451,919	\$1,509,800
Accounts Payable and Accrued Expenses	\$ 286,467	\$ 292,856
Current Portion of Long Term Debt	886,860	889,186
Total Current Liabilities	1,173,327	1,182,042
Other Liabilities & Deferred Gains	251,829	257,437
Stockholders Equity		
Preferred stock, \$1 par value; 10,000,000 shares authorized; no shares issued		
Common stock, \$0.01 par value; 50,000,000 shares authorized; 38,377,504 and 38,347,898 shares issued, respectively	383	383
Treasury stock at cost; 1,050 shares	(4)	(4)
Additional Paid in Capital	306,303	305,927
Accumulated Deficit	(279,957)	(236,024)
Accumulated other comprehensive loss	38	38
Stockholders Equity	26,763	70,321
Total Liabilities & Stockholders Equity	\$1,451,919	\$1,509,800

*Financial information subject to change

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Atlas Air Worldwide Holdings, Inc.
Consolidated Statement of Cash Flows (000s) *
(UNAUDITED)

	<u>Six Months Ended June 30, 2003</u>	<u>Three Months Ended June 30, 2003</u>	<u>Three Months Ended March 31, 2003</u>
Cash Flow from Operating Activities:			
Net Loss	\$ (65,259)	\$ (43,933)	\$ (21,326)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Depreciation and amortization	35,977	21,524	14,453
Common stock issued as compensation	283		283
Recognition of compensation from Restricted Stock Units	442	377	65
Provision for doubtful accounts	4,579	3,413	1,166
Amortization of debt issuance cost and lease financing deferred (gains)	(5,387)	(2,687)	(2,700)
Loss on disposal of fixed assets	4,322	4,322	
Purchase deposit reclassification	2,888		2,888
Other, net	(2,875)	(1,783)	(1,092)
Changes in operating assets and liabilities:			
Accounts receivable and other	99	19,024	(18,925)
Prepays and other current assets	(41,537)	6,306	(47,843)
Deposits and other assets	5,028	(1,681)	6,709
Accounts payable and accrued liabilities	(6,174)	(4,635)	(1,539)
Net cash (used for) provided by operating activities	(67,614)	247	(67,861)
Cash Flow from Investing Activities:			
Capital expenditures	(6,917)	(2,567)	(4,350)
Net proceeds from the disposal of fixed assets	7,786	7,786	
Net cash provided by (used for) investing activities	869	5,219	(4,350)
Cash Flow from Financing Activities			
Purchase of treasury stock	(217)		(217)
Payments on long-term debt and capital lease obligations	(43,782)	(2,326)	(41,456)
Debt issuance costs and deferred lease costs	(375)		(375)
Net cash used for financing activities	(44,374)	(2,326)	(42,048)
Net decrease in cash	(111,119)	3,140	(114,259)
Cash at the beginning of period	253,848	139,589	253,848
Cash at end of period	\$ 142,729	\$ 142,729	\$ 139,589

*Financial information subject to change

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Atlas Air, Inc. and Polar Air Cargo, Inc.
Select Financial Data (000s) *
(UNAUDITED)

Atlas Air , Inc.

	As At and For The Six Months Ended June 30, 2003	As At and For The Three Months Ended	
	June 30, 2003	June 30, 2003	March 31, 2003
Operating Revenue	\$ 408,781	\$ 193,625	\$ 215,156
Aircraft Rent	68,078	32,733	35,345
Depreciation	29,428	15,408	14,020
Other Operating Expense	306,053	147,579	158,475
	<u> </u>	<u> </u>	<u> </u>
Operating Expense	403,559	195,720	207,840
Operating Income (Loss)	\$ 5,222	\$ (2,095)	\$ 7,316
	<u> </u>	<u> </u>	<u> </u>
Capital Expenditures	\$ 5,992	\$ 2,171	\$ 3,821
	<u> </u>	<u> </u>	<u> </u>
Cash and Cash Equivalents	\$ 115,356	\$ 115,356	\$ 112,790
	<u> </u>	<u> </u>	<u> </u>

Polar Air Cargo, Inc.

	As At and For The Six Months Ended June 30, 2003	As At and For The Three Months Ended	
	June 30, 2003	June 30, 2003	March 31, 2003
Operating Revenue	\$ 327,362	\$ 167,742	\$ 159,620
Aircraft Rent	85,017	47,730	37,287
Depreciation	6,550	6,117	433
Other Operating Expense	265,103	135,264	129,839
	<u> </u>	<u> </u>	<u> </u>
Operating Expense	356,670	189,111	167,559
Operating Loss	\$ (29,308)	\$ (21,369)	\$ (7,939)
	<u> </u>	<u> </u>	<u> </u>
Capital Expenditures	\$ 925	\$ 396	\$ 529
	<u> </u>	<u> </u>	<u> </u>
Cash and Cash Equivalents	\$ 26,240	\$ 26,240	\$ 23,248
	<u> </u>	<u> </u>	<u> </u>

* Selected Financial Data subject to change

Table of Contents**Debt Balances and Collateral**

As of June 30, 2003

Obligor	Creditor	Description	Balance	Collateral	Guarantor
AAI	Bank	Loan	\$ 47,018,891	2 B747-200s & 1 B747-300	AAWH
	Senior Notes (10.75%)	Loan	137,475,000	Unsecured	N/A
	Senior Notes (9.25%)	Loan	153,000,000	Unsecured	N/A
	Senior Notes (9.38%)	Loan	147,000,000	Unsecured	N/A
	EETC-98	Issuance (A)	55,301,144	1 B747-400	N/A
		Issuance (B)	15,371,146	See Issuance A above	N/A
		Issuance (C)	5,236,589	See Issuance A above	N/A
	EETC-99	Issuance (A-1)	12,947,413	1 B747-400	N/A
		Issuance (A-2)	43,544,000	See Issuance A-1 above	N/A
		Issuance (B)	18,050,575	See Issuance A-1 above	N/A
		Issuance (C)	14,305,236	See Issuance A-1 above	N/A
	Bank	Loan	19,253,295	1 B747-300	N/A
	Bank	Loan	24,879,852	1 B747-200	N/A
	Bank	Loan	6,701,267	1 B747-200	N/A
	Bank	Capital Lease	3,390,505	1 Flight Simulator	N/A
	Bank	Capital Lease	417,999	See Capital Lease above	N/A
		AAI Total	\$ 703,892,912		
AFL III	Bank	Tranche A Loan	\$ 79,144,683	13 B747-200s and 12 spare	AAWH*
	Bank	Tranche B Loan	99,275,521	engines in total for	AAWH*
				both tranches	
		AFL III Total	\$ 178,420,204		
PO	N/A	N/A	-	N/A	N/A
AAWH	Financial	Loan	\$ 4,660,000	1 B747-200; Polar	PO
	Institution			Receivables	
AAWH Total			\$ 886,973,116		

Notes:

AAI = Atlas Air, Inc.

AAWH = Atlas Air Worldwide Holdings, Inc.

AFL = Atlas Freighter Leasing

N/A = Not Applicable

PO = Polar Air Cargo, Inc.

* With respect to AFL III, AAWH guarantees the lease obligations running from AAI to AFL III, but not the AFL III debt

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Atlas Air Worldwide Holdings, Inc.

DATE: September 12, 2003

By: /s/ David W. Lancelot

David W. Lancelot
Senior Vice President & Chief Financial Officer

Atlas Air, Inc.

DATE: September 12, 2003

By: /s/ David W. Lancelot

David W. Lancelot
Senior Vice President & Chief Financial Officer

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