

Capital Financial Holdings, Inc
Form 10-Q
May 15, 2013

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

FORM 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _____ to _____

Commission file number: 0-25958

CAPITAL FINANCIAL HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

North Dakota
(State or other jurisdiction of incorporation
or organization)

45-0404061
(I.R.S. Employer Identification No.)

1 Main Street North
Minot, North Dakota 58703
(Address of principal executive offices) (Zip code)

(701) 837-9600
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-----------------------|---------------------------|-----------------------|
| Large accelerated filer | <input type="radio"/> | Accelerated filer | <input type="radio"/> |
| Non-accelerated filer | <input type="radio"/> | Smaller reporting company | <input type="radio"/> |

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

As of March 31, 2013, there were 14,455,943 common shares of the issuer outstanding.

FORM 10-Q

CAPITAL FINANCIAL HOLDINGS, INC.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARY
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

| | (Unaudited) | |
|---|--------------------|-------------------------|
| | March 31, 2013 | December 31, 2012 |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$1,108,696 | \$1,221,606 |
| Accounts receivable (net of an allowance of \$24,000 for 2013 and 2012) | 1,454,023 | 1,308,157 |
| Deferred tax asset – current | 5,088 | 8,933 |
| Prepays | 27,288 | 38,077 |
| Total current assets | \$2,595,095 | \$2,576,773 |
| PROPERTY AND EQUIPMENT | | |
| Property and equipment | \$341,015 | \$328,347 |
| Less accumulated depreciation | (286,090) | (279,485) |
| Net property and equipment | \$54,925 | \$48,862 |
| OTHER ASSETS | | |
| Goodwill | \$2,132,026 | \$2,132,026 |
| Severance escrow | 254,259 | 254,196 |
| Deferred tax asset – non-current | 535,851 | 539,132 |
| Other assets (net of accumulated amortization of \$214,444 for 2013 and 2012) | 192,877 | 225,890 |
| Total other assets | \$3,115,013 | \$3,151,244 |
| TOTAL ASSETS | \$5,765,033 | \$5,776,879 |

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Table of ContentsCONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)
LIABILITIES AND STOCKHOLDERS' EQUITY

| | (Unaudited) | |
|--|---------------------|-------------------------|
| | March 31, 2013 | December 31, 2012 |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 115,097 | \$ 172,390 |
| Commissions payable | 1,572,539 | 1,301,194 |
| Other current liabilities | 38,541 | 99,320 |
| Current portion of long-term liabilities | - | 125,668 |
| Total current liabilities | \$ 1,726,177 | \$ 1,698,572 |
| LONG-TERM LIABILITIES | | |
| Promissory note | - | 67,173 |
| Other long-term liabilities | 22,000 | - |
| Total long-term liabilities | \$ 22,000 | \$ 67,173 |
| TOTAL LIABILITIES | \$ 1,748,177 | \$ 1,765,745 |
| STOCKHOLDERS' EQUITY | | |
| Series A preferred stock – 5,000,000 shares authorized, \$.0001 par value; 3,050,000 and 3,050,000 shares issued and 0 outstanding, respectively | \$ 305 | \$ 305 |
| Additional paid in capital – series A preferred stock | 1,524,695 | 1,524,695 |
| Common stock – 1,000,000,000 shares authorized, \$.0001 par value; 14,455,943 and 14,455,943 shares issued and outstanding, respectively | 1,446 | 1,446 |
| Additional paid in capital – common stock | 10,446,302 | 10,446,302 |
| Accumulated deficit | (6,655,892) | (6,661,614) |
| Less Treasury stock, 3,050,000 preferred shares at \$0.4262 | (1,300,000) | (1,300,000) |
| TOTAL STOCKHOLDERS' EQUITY | \$ 4,016,856 | \$ 4,011,134 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 5,765,033 | \$ 5,776,879 |

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | (Unaudited) | |
|---|--------------------|-------------------|
| | Three Months Ended | |
| | March 31, | |
| | 2013 | 2012 |
| OPERATING REVENUES | | |
| Fee income | \$229,585 | 259,305 |
| Commissions | 5,109,867 | 3,864,888 |
| Interest and other income | 122,688 | 36,585 |
| Total revenue | \$5,462,140 | 4,160,778 |
| OPERATING EXPENSES | | |
| Compensation and benefits | \$300,349 | 263,261 |
| Commission expense | 4,758,550 | 3,569,916 |
| General and administrative expenses | 367,042 | 449,969 |
| Depreciation and amortization | 6,604 | 14,892 |
| Goodwill impairment | - | 314,531 |
| Total operating expenses | \$5,432,545 | 4,612,569 |
| OPERATING INCOME (LOSS) | \$29,595 | (451,791) |
| OTHER INCOME (EXPENSES) | | |
| Interest expense | \$(3,907) | (21,769) |
| INCOME (LOSS) OF CONTINUING OPERATIONS BEFORE INCOME TAX | | |
| EXPENSE | 25,688 | (473,560) |
| INCOME TAX BENEFIT (EXPENSE) | \$(19,966) | 75,766 |
| NET INCOME (LOSS) | \$5,722 | (397,794) |
| NET INCOME PER COMMON SHARE: | | |
| Basic | \$.00 | (.03) |
| Diluted | \$.00 | (.03) |
| SHARES USED IN COMPUTING NET PER COMMON SHARE: | | |
| Basic | 14,455,943 | 14,455,943 |
| Diluted | 14,455,943 | 14,455,943 |

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | (Unaudited) Three Months Ended March 31, | |
|--|--|-------------------|
| | 2013 | 2012 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | \$5,722 | (397,794) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation | 6,604 | 14,892 |
| Goodwill impairment | - | 314,531 |
| Loss on disposal of assets | - | 74,651 |
| Provision for income taxes | 7,126 | (84,047) |
| (Increase) decrease in: | | |
| Accounts receivable | (145,866) | 14,294 |
| Prepays & other | 43,803 | 17,311 |
| Severance escrow | (63) | (30,905) |
| Accounts payable | (57,293) | 30,784 |
| Commissions payable | 271,345 | 59,559 |
| Other liabilities | (60,779) | (116,965) |
| Net cash provided by (used in) operating activities | \$70,599 | (103,689) |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Purchase of property and equipment | \$(12,668) | (3,909) |
| Proceeds from sale of building | - | 931,245 |
| Net cash (used in) provided by investing activities | \$(12,668) | 927,336 |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Repayment of long-term liability | (125,668) | (19,410) |
| Increase in Settlements payable | 22,000 | |
| Repayment of promissory note | (67,173) | (948,235) |
| Net cash used in financing activities | \$(170,841) | (967,645) |
| NET (DECREASE) IN CASH AND CASH EQUIVALENTS | \$(112,910) | (143,998) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR | \$1,221,606 | 929,030 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$1,108,696 | 785,032 |
| SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES: | | |
| Cash paid for interest | 5,512 | 21,769 |

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
March 31, 2013 and 2012

NOTE 1 - BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements of Capital Financial Holdings, Inc., a North Dakota corporation, and its subsidiary (collectively, the "Company"), included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the footnotes thereto contained in the Annual Report on Form 10-K for the year ended December 31, 2012, of Capital Financial Holdings, Inc., as filed with the SEC. The condensed consolidated balance sheet at December 31, 2012, contained herein, was derived from audited financial statements, but does not include all disclosures included in the Form 10-K and applicable under accounting principles generally accepted in the United States of America. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America, but not required for interim reporting purposes, have been condensed or omitted.

In the opinion of the Company, the accompanying unaudited condensed consolidated financial statements contain all adjustments (which are of a normal, recurring nature) necessary for a fair presentation of the financial statements. The results of operations for the three months ended March 31, 2013, are not necessarily indicative of operating results for the entire year.

NOTE 2 - RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

A summary of our significant accounting policies is included in Note 1 on pages 10 and 11 of our 2012 Form 10-K.

The Company adopted ASC 820-10, Fair Value Measurements and Disclosures, for nonfinancial assets and liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The adoption of ASC 820-10 did not have a material impact on the Company's condensed consolidated financial statements.

The Company adopted ASU 2012-02, Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. ASU 2012-02 simplifies how an entity tests indefinite-lived intangibles assets other than goodwill for impairment. Another objective of ASU 2012-02 is to improve the consistency of impairment testing guidance among long-term asset categories. The amendments are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of ASU 2012-02 did not have a material impact on the Company's condensed consolidated financial statements.

NOTE 3 - RECLASSIFICATION

Certain amounts in the 2012 condensed consolidated financial statements have been reclassified to conform to the 2013 presentation. These reclassifications had no effect on the Company's net income (loss).

NOTE 4 - BUSINESS ACQUISITIONS

On March 7, 2007, the Company acquired certain assets of United Heritage Financial Services, Inc. (UHFS), a wholly owned subsidiary of United Heritage Financial Group, Inc., of Meridian, Idaho. UHFS had approximately 120 independent registered representatives who became part of Capital Financial Services, Inc. (CFS), the retail brokerage division of the Company. Pursuant to the agreement, in exchange for receipt of the assets of UHFS set forth above, the

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Company agreed to issue 500,000 restricted CFH shares and pay a deferred cash earn out payment totaling a maximum of \$900,000, to be paid in 21 quarterly installments. As of March 31, 2013 the Company had made twenty-one quarterly installment payments. There is no longer a liability relating to this acquisition as of March 31, 2013. Due to the goodwill impairment charge that was recorded on December 31, 2010 and March 31, 2012(See Note 5-Goodwill), as of March 31, 2013 the total goodwill recorded relating to this acquisition was \$456,410.

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NOTE 5 - GOODWILL

The changes in the carrying amount of goodwill for the three months ended March 31, 2013, are as follows:

| | |
|--|-------------|
| Balance as of January 1, 2013 | \$2,132,026 |
| Impairment loss on goodwill | - |
| Goodwill acquisition price adjustment during the period (See Note 4) | - |
| Balance as of March 31, 2013 | \$2,132,026 |

The Company's goodwill represents the excess of purchase prices over the fair value of the identifiable net assets of previously acquired broker/dealer businesses. The goodwill is not amortized; instead it is tested for impairment annually or more frequently if the fair value of a reporting unit is below its carrying value. Absent any impairment indicators, the Company performs its annual goodwill impairment testing as of June 30 of each year.

The Company's policy is to test goodwill for impairment using a fair value approach at the reporting unit level. The Company performs its goodwill impairment test in two steps. Step one compares the fair value of the reporting unit to its carrying value, including goodwill. If the fair value of the unit determined in step one is lower than its carrying value, the Company proceeds to step two, which then compares the carrying value of goodwill to its implied fair value. Any excess of carrying value of goodwill over its implied fair value at a reporting unit is recorded as impairment.

The valuation methodology the Company utilizes in testing the Company's goodwill for impairment is based on the income approach. The income approach is based on a discounted cash flow methodology in which expected future net cash flows are discounted to present value, using a discounted rate that compensates for the risk in attaining the projected cash flows. This approach is dependent upon a number of significant management estimates about future performance including but not limited to, market performance, income taxes, capital spending and working capital changes.

The Company tests goodwill for impairment annually during the second quarter of each fiscal year. If an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value, goodwill will be evaluated for impairment between annual tests. There were no events that occurred nor a change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying value during the first quarter in 2013. Therefore, the second step of testing for impairment was not required.

NOTE 6 - PROMISSORY NOTE

On October 21, 2011, the Company issued a promissory note to PawnMart, Inc. in exchange for the repurchase of the 3,050,000 shares of preferred stock. The note carries an interest rate of 7%, with quarterly payments of \$66,801. On March 30, 2012 the Company revised the agreement with PawnMart, Inc. to release the building as security on the original note. The Company made a payment of \$925,922. In April of 2012, the Company made a \$100,000 payment. The Company was to make quarterly payments of \$34,000 with the last payment being \$34,965 until maturity April 1, 2014. On March 1, 2013, the Company made a payment of \$118,000. On March 28, 2013 the Company paid the promissory note in full plus accrued interest for a total payment of \$46,353. Interest expense on this note was \$5,512 in 2013 and \$31,826 in 2012. There is no longer a liability related to this note.

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NOTE 7 - EARNINGS PER SHARE

Basic earnings per share are computed by dividing earnings available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect per share amounts that would have resulted if dilutive potential common shares had been converted to common shares. The following reconciles amounts reported in the financial statements:

| | Three Months Ended March 31, 2013 | | | Three Months Ended March 31, 2012 | | |
|--|-----------------------------------|-------------|------------------|-----------------------------------|-------------|------------------|
| | Numerator | Denominator | Per Share Amount | Numerator | Denominator | Per Share Amount |
| Net (Loss) Income | \$5,722 | | | (397,794) | | |
| Less: Preferred Stock Dividends | | | | | | |
| Income Available to Common Shareholders – Basic Earnings per Share | \$5,722 | 14,455,943 | .00 | (397,794) | 14,455,943 | \$(.03) |
| Effect of Dilutive Securities: | | | | | | |
| Preferred Stock Dividends | | | | | | |
| Stock Options and Warrants | | | | | | |
| Income Available to Common Shareholders – Diluted Earnings per Share | \$5,722 | 14,455,943 | .00 | (397,794) | 14,455,943 | \$(.03) |

Options and warrants to purchase 7,486,113 common shares at exercise prices between \$0.35 and \$1.43 were outstanding at March 31, 2013, but were not included in the computation of diluted earnings per share for the quarter ending March 31, 2013, because their effect was anti-dilutive.

NOTE 8 - FAIR VALUE DISCLOSURES

The Company has adopted a framework for measuring fair value, and establishes a fair value hierarchy which prioritizes the inputs to valuation techniques. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market. Valuation techniques that are consistent with the market, income or cost approach are used to measure fair value.

The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value in three broad levels:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities the Company has the ability to access.

Level 2 inputs are inputs (other than quoted prices included within level 1) that are observable for the asset or liability, either directly or indirectly.

Level 3 are unobservable inputs for the asset or liability and rely on management's own assumptions about the assumptions that market participants would use in pricing the asset or liability. (The unobservable inputs should be developed based on the best information available in the circumstances and may include the Company's own data.)

The application of valuation techniques applied to similar assets and liabilities has been consistently applied. The following is a description of the valuation methodologies used for instruments measured at fair value:

On February 12, 2009, CFS entered into a settlement agreement with a client, which resulted in CFS purchasing the client's investment in the Omega 2007 Drilling Program 1, LP. This limited partnership carries a "presentment" feature which allows CFS to sell the investment to the General Managing Partner of the limited partnership; and this feature has become available. CFS had determined, based off of information provided by the Limited Partnership that the fair market value of the \$76,876 investment was estimated at \$45,000 based on discounted cash flows at the time of purchase by CFS. Since then, CFS has determined, based off of information provided by the Limited Partnership that, as of March 19, 2013, the fair market value of this \$76,876 investment is estimated to be \$12,214 based on discounted cash flows; however this amount could fluctuate with the prices of oil and natural gas. As of May 13, 2013, the Company has opted to exercise the Presentment Feature. This investment is included in other assets on the balance sheet.

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The Company has accumulated cash for the possible future payments of severance and benefits for senior management, should they leave. This is an accrual the company has elected to set aside for possible future obligations. These funds are reflected as Severance Escrow on the balance sheet, and consist of cash accounts.

| | Carrying Value at March 31, 2013 | | | | Quarter ended March 31, 2013 |
|------------------|----------------------------------|---------|---------|----------|------------------------------|
| | Total | Level 1 | Level 2 | Level 3 | Total Losses |
| Other Investment | \$12,214 | \$- | \$- | \$12,214 | \$- |
| Severance Escrow | 254,259 | 254,259 | | | |

| | Carrying Value at March 31, 2012 | | | | Quarter ended March 31, 2012 |
|------------------|----------------------------------|---------|---------|----------|------------------------------|
| | Total | Level 1 | Level 2 | Level 3 | Total Losses |
| Other Investment | \$45,000 | \$- | \$- | \$45,000 | \$- |
| Severance Escrow | 260,473 | 260,473 | | | |

Reconciliation of Level 3 Balances:

| | | |
|---------------------------------|----|--------|
| Balance as of January 1, 2012 | \$ | 45,000 |
| Loss on other investment | | - |
| Balance as of December 31, 2012 | | 45,000 |
| Loss on other investment | | 32,786 |
| Balance as of March 31, 2013 | \$ | 12,214 |

NOTE 9 - LEGAL PROCEEDINGS

The Company operates in a legal and regulatory environment that exposes it to potentially significant litigation risks. As a result, the Company is involved in various disputes and legal proceedings, including litigation, arbitration and regulatory investigations. Issuers of certain alternative products sold by the Company are in Chapter 11 Bankruptcy or may have other financial difficulties. As a result of such alleged failings of alternative products and the uncertainty of client recovery from the various product issuers, the Company is subject to several legal and/or arbitration proceedings. These proceedings include customer suits and arbitrations related to the bankruptcy of the KH Funding Company, and the bankruptcy proceedings of the various DBSI entities RMC Medstone and Cole Credit Property Trust. The Company vigorously contests the allegations of the various proceedings and believes that there are multiple meritorious legal and fact based defenses in these matters. Such cases are subject to many uncertainties, and their outcome is often difficult to predict, including the impact on operations or on the financial statements, particularly in the earlier stages of a case. The Company makes provisions for cases brought against it when, in the opinion of management after seeking legal advice, it is probable that a liability exists, and the amount can be reasonably estimated. The current proceedings are subject to uncertainties and as such, the Company is unable to estimate the possible loss or range of loss that may result from the outcome of these cases; however, results in these cases that are against the interests of the Company could have a severe negative impact on the financial position of the Company. At March 31, 2013, the Company is a defendant in five on-going suits and arbitrations as discussed above. The Company

expects any possible settlement, if any, to be below the maximum limits of coverage under our liability insurance policy and any amounts of shared coverage by the Company, to the insurance Company is not material to the financial statements. However, the Company expects to prevail in these cases. During 2012, The Company settled lawsuits that will require \$44,000 in payments during 2013 and 2014. During the second quarter of 2013, an agreement for one of the arbitrations mentioned above was reached. On May 7, 2013, Company made payment of approximately \$19,000 to their insurance provider in order to satisfy this agreement. No further payments will be required on the aforementioned settled lawsuits.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Capital Financial Holdings, Inc. derives the majority of its revenues and net income from sales of mutual funds, insurance products, and various other securities through Capital Financial Services, Inc. ("CFS"), the Company's broker-dealer subsidiary.

The Company has been engaged in the financial services business since 1987. The Company was incorporated September 22, 1987, as a North Dakota corporation. The Company's principal offices are located at 1 Main Street North, Minot, North Dakota 58703. As of March 31, 2013, the Company had 17 full-time employees and 2 part-time employees consisting of officers, securities distribution, data processing, compliance, accounting, and clerical support staff.

CFS is a full-service brokerage firm. CFS is registered with the SEC as an investment advisor and broker-dealer and also with FINRA as a broker-dealer. CFS specializes in providing investment products and services to independent investment representatives, financial planners, and investment advisors and currently supports over 222 investment representatives and investment advisors.

RESULTS OF OPERATIONS

| | Three Months Ended March 31, | |
|-------------------|---------------------------------|-----------|
| | 2013 | 2012 |
| Net income (loss) | 5,722 | (397,794) |
| Income per share: | | |
| Basic | .00 | (.03) |
| Diluted | .00 | (.03) |

The Company reported net income for the quarter ended March 31, 2013, of \$5,722, compared to net loss of \$397,794 for the same quarter in 2012.

Operating revenues

Total operating revenues for the quarter ended March 31, 2013 were \$5,462,140, an increase of 31% from \$4,160,778 for the quarter ended March 31, 2012. The increases for the three month period resulted primarily from increases in commission income received by CFS, the Company's broker-dealer division.

Fee Income

Fee income for the quarter ended March 31, 2013 was \$229,585, a decrease of 11% from \$259,305 for the quarter ended March 31, 2012. The decreases were due to decline in fee income received by CFS, as a result of lower values of client assets under management.

The Company earns investment advisory fees in connection with CFS' registered investment advisor. The Company pays the registered representatives a portion of this fee income as commission expense and retains the balance. These fees constituted 4% of the Company's consolidated revenues for 2013.

Commission Income

Commission income includes CFS commissions. The Company pays the registered representatives a percentage of this income as commission expense and retains the balance. Commission income for the quarter ended March 31, 2013 was \$5,109,867, an increase of 32% from \$3,864,888 for the quarter ended March 31, 2012. The increases were due primarily to the increase in commissions received by CFS due to market conditions. Commission revenues constituted 94% of the Company's consolidated revenues for 2013.

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Other income

Interest and other income for the quarter ended March 31, 2013 was \$122,688, an increase of 235% from \$36,585 for the quarter ended March 31, 2012. The increases were due to an increase in the marketing income received related to alternative investment products. Interest and other income constituted 2% of the Company's consolidated revenues for the three months ended March 31, 2013.

Operating expenses

Total operating expenses for the quarter March 31, 2013 were \$5,432,545, an increase of 18% from \$4,612,569 for the quarter ended March 31, 2012. The increases resulted from the net increase in the expense categories described below.

Compensation and benefits

Compensation and benefits expense for the quarter ended March 31, 2013 was \$300,349, an increase of 14% from \$263,261 for the quarter ended March 31, 2012. The increases resulted from an increase in wages and benefits to employees and payroll taxes.

Commission expense

Commission expense for the quarter ended March 31, 2013 was \$4,758,550, an increase of 33% from \$3,569,916 for the quarter ended March 31, 2012. The increase in commission expense corresponds with the increase in commission income for the quarter.

General and administrative expense

Total general and administrative expenses for the quarter ended March 31, 2013 were \$367,042, a decrease of 18% from \$449,969 for the quarter ended March 31, 2012. The decreases were due primarily to a decrease in the legal expenses incurred through litigation costs, outside professional services, and expenses no longer applicable in 2013 due to the sale of the building in 2012.

Depreciation and amortization

Depreciation and amortization expense for the quarter ended March 31, 2013 was \$6,604, a decrease of 56% from \$14,892 for the quarter ended March 31, 2012. The primary difference corresponds with the sale of the building and the disposal of assets that occurred during 2012.

Liquidity and capital resources

Net cash provided by operating activities was \$70,599 for the three months ended March 31, 2013, as compared to net cash used in operating activities of \$103,689 during the three months ended March 31, 2012. The primary difference corresponds to the goodwill impairment recorded in 2012.

Net cash used in investing activities was \$12,668 for the three months ended March 31, 2013, compared to net cash provided by investing activities of \$927,336 for the three months ended March 31, 2012. The primary difference corresponds with the sale of the building and the disposal of assets that occurred during 2012.

Net cash used in financing activities was \$170,841 for the three months ended March 31, 2013, compared to net cash used in financing activities of \$967,645 for the three months ended March 31, 2012. The primary difference

corresponds with the early repayment of the promissory note with PawnMart.

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At March 31, 2013, the Company held \$1,108,696 in cash and cash equivalents, as compared to \$785,032 at March 31, 2012. The Company is required to maintain certain levels of cash and liquid securities in CFS to meet regulatory net capital requirements.

The Company currently has no lines of credit available.

The Company has historically relied upon sales of its equity securities and debt instruments, as well as bank loans, for liquidity and growth. Management believes that the Company's existing liquid assets, along with cash flow from operations, will provide the Company with sufficient resources to meet its ordinary operating expenses during the next twelve months. Significant, unforeseen or extraordinary expenses may require the Company to seek alternative financing sources, including common or preferred share issuance or additional debt financing.

In addition to the liabilities coming due in the next twelve months, management expects that the principal needs for cash may be broker recruitment, repurchase shares of the Company's common stock, and debt service. Management also expects to realize increases in consultant expenses as well as increased compliance and legal costs with respect to its broker dealer subsidiary related to regulatory and litigation matters.

FORWARD-LOOKING STATEMENTS

When used herein, in future filings by the Company with the Securities and Exchange Commission ("SEC"), in the Company's press releases, and in other Company-authorized written or oral statements, the words and phrases "can be," "expects," "anticipates," "may affect," "may depend," "believes," "estimate," or similar expressions are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. The Company cautions readers not to place undue reliance on any such forward-looking statements, which speak only as of the date made. Such statements are subject to certain risks and uncertainties, including those set forth in this "Forward-Looking Statements" section, which could cause actual results for future periods to differ materially from those presently anticipated or projected. The Company does not undertake and specifically disclaims any obligation to update any forward-looking statement to reflect events or circumstances after the date of such statements.

Forward-looking statements include, but are not limited to, statements about the Company's:

- Business strategies and investment policies,
- Possible or assumed future results of operations and operating cash flows,
- Financing plans and the availability of short-term borrowing,
- Competitive position,
- Potential growth opportunities,
- Recruitment and retention of the Company's key employees,
- Potential operating performance, achievements, productivity improvements, efficiency and cost reduction efforts,
- Likelihood of success and impact of litigation,
- Expected tax rates,
- Expectations with respect to the economy, securities markets, the market for merger and acquisition activity, the market for asset management activity, and other industry trends,
- Competition, and
- Effect from the impact of future legislation and regulation on the Company.

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The following factors, among others, could cause actual results to differ materially from forward-looking statements, and future results could differ materially from historical performance:

- General political and economic conditions which may be less favorable than expected;
- The effect of changes in interest rates, inflation rates, the stock markets, or other financial markets;
- Unfavorable legislative, regulatory, or judicial developments;
- Adverse findings or rulings in arbitrations, litigation or regulatory proceedings;
- Incidence and severity of catastrophes, both natural and man-made;
- Changes in accounting rules, policies, practices, and procedures which may adversely affect the business;
- Terrorist activities or other hostilities which may adversely affect the general economy.

The Company is a financial services holding company that, through its broker dealer subsidiary, provides brokerage, investment advisory, insurance and related services. The Company operates in a highly regulated and competitive industry that is influenced by numerous external factors such as economic conditions, marketplace liquidity and volatility, monetary policy, global and national political events, regulatory developments, competition, and investor preferences. The Company's revenues and net earnings may be either enhanced or diminished from period to period by such external factors. The Company remains focused on continuing to reduce redundant operating costs, upgrade operating efficiency, recruit quality representatives and grow our revenue base. The Company provides broker-dealer services in support of trading and investment by its representatives' customers in corporate equity and debt securities, U.S. Government securities, municipal securities, mutual funds, private placement alternative investments, variable annuities and variable life insurance. The Company also provides investment advisory services for its representative's customers

A key component of the broker-dealer subsidiary's business strategy is to recruit well-established, productive representatives who generate substantial revenues from an array of investment products and services. Additionally, the broker-dealer subsidiary assists its representatives in developing and expanding their business by providing a variety of support services and a diversified range of investment products for their clients.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not Applicable as a Smaller Reporting Company

ITEM 4. CONTROLS AND PROCEDURES

The Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-14(c) and Rule 15c-14(c) under the Exchange Act) as of the end of the period covered by this report, pursuant to Rule 13a-15(b) of the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective as of March 31, 2013, and that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed and summarized, and reported within the time periods specified by the SEC's rules and forms.

Disclosure controls and procedures are the controls and other procedures that are designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies or material weaknesses.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company operates in a legal and regulatory environment that exposes it to potentially significant litigation risks. As a result, the Company is involved in various disputes and legal proceedings, including litigation, arbitration and regulatory investigations. Issuers of certain alternative products sold by the Company are in Chapter 11 Bankruptcy or may have other financial difficulties. As a result of such alleged failings of alternative products and the uncertainty of client recovery from the various product issuers, the Company is subject to several legal and/or arbitration proceedings. These proceedings include customer suits and arbitrations related to the bankruptcy of the KH Funding Company, and the bankruptcy proceedings of the various DBSI entities RMC Medstone and Cole Credit Property Trust. The Company vigorously contests the allegations of the various proceedings and believes that there are multiple meritorious legal and fact based defenses in these matters. Such cases are subject to many uncertainties, and their outcome is often difficult to predict, including the impact on operations or on the financial statements, particularly in the earlier stages of a case. The Company makes provisions for cases brought against it when, in the opinion of management after seeking legal advice, it is probable that a liability exists, and the amount can be reasonably estimated. The current proceedings are subject to uncertainties and as such, the Company is unable to estimate the possible loss or range of loss that may result from the outcome of these cases; however, results in these cases that are against the interests of the Company could have a severe negative impact on the financial position of the Company. At March 31, 2013, the Company is a defendant in five on-going suits and arbitrations as discussed above. The Company expects any possible settlement, if any, to be below the maximum limits of coverage under our liability insurance policy and any amounts of shared coverage by the Company, to the insurance Company is not material to the financial statements. However, the Company expects to prevail in these cases. During 2012, The Company settled lawsuits that will require \$44,000 in payments during 2013 and 2014. During the second quarter of 2013, an agreement for one of the arbitrations mentioned above was reached. On May 7, 2013, Company made payment of approximately \$19,000 to their insurance provider in order to satisfy this agreement. No further payments will be required on the aforementioned settled lawsuits.

ITEM 1A. RISK FACTORS

Not Applicable as a Smaller Reporting Company

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

The Company has issued the following securities in the past quarter without registering the securities under the Securities Act:

None

Small Business Issuer Repurchases of Equity Securities:

In November of 1997, the Board of Directors of the Company authorized the repurchase of up to \$2,000,000 of its outstanding common stock from time to time in the open market. The table below displays the dollar value of shares that may yet be purchased under this plan.

| Period | Total Number of Shares Purchased | Average Price Per Share | Total Number of Shares Purchased | Approximate Dollar Value of Shares That May |
|--------|---|-------------------------------|---|--|
|--------|---|-------------------------------|---|--|

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| | | | as Part of Publicly Announced Plans or Programs | Yet Be Purchased Under the Plans or Programs |
|---------------|---|---|---|--|
| January 2013 | - | - | - | \$ 597,754 |
| February 2013 | - | - | - | \$ 597,754 |
| March 2013 | - | - | - | \$ 597,754 |
| Total | - | - | - | \$ 597,754 |

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibits

31.1 CEO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act

31.2 CFO Certification Pursuant to Section 302 of the Sarbanes-Oxley Act and Rules 13a-14(a) and 15d-14(a) of the Exchange Act

32.1 CEO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350

32.2 CFO Certification Pursuant to Section 906 of the Sarbanes-Oxley Act and 18 U.S.C. Section 1350

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CAPITAL FINANCIAL HOLDINGS, INC.

SIGNATURES

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

CAPITAL FINANCIAL HOLDINGS,
INC.

Date: May 15, 2013

By: /s/ John Carlson
John Carlson
Chief Executive Officer & President
(Principal Executive Officer)

Date: May 15, 2013

By: /s/ Elizabeth Redding
Elizabeth A. Redding
Chief Financial Officer & Corporate
Secretary
(Principal Financial Officer)