

Capital Financial Holdings, Inc  
Form 10-Q  
November 12, 2010

**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 period ended September 30, 2010

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)

(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

[

X

]

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

[

]

Accelerated filer

[

]

Non-accelerated filer

[

]

Smaller reporting company

[

X

]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

[

]

No

[

X

]

As of October 31, 2010, there were 14,455,943 common shares of the issuer outstanding.

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**PART I—FINANCIAL INFORMATION**

**Item 1.**

**Financial Statements**

**CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS**

**ASSETS**

(Unaudited)  
September 30,  
2010

December 31,  
2009

**CURRENT ASSETS**

Cash and cash equivalents

\$  
2,153,606

\$

	1,968,738
Accounts receivable (net of an allowance of \$24,000 for 2010 and 2009)	
	1,339,224
	1,242,630
Income taxes receivable	
	70,431
	173,502
Deferred tax asset—current	
	-
	45,032
Current portion of long-term receivable	
	227,200
	254,247

Prepays

40,318

27,849

Total current assets

\$

3,830,779

\$

3,711,998

**LONG-TERM ASSETS**

Acquisition Costs—Oil & Gas Leases

\$

152,384

\$

-

LT receivable—MF Division Sale

454,400

762,740

Less: current portion shown above

(227,200)

(254,247)

Total long-term assets

\$

379,584

508,493

**PROPERTY AND EQUIPMENT**

\$

1,727,320

\$

1,711,245

Less accumulated depreciation

(589,331)

(536,395)



Net property and equipment

\$  
1,137,989  
\$  
1,174,850

**OTHER ASSETS**

Goodwill

\$  
3,355,441  
\$  
3,431,641

Deferred tax asset

456,497

474,755

Other assets (net of accumulated amortization

225,451

198,991

of \$214,444 for 2010 and \$209,422 for 2009)

Total other assets

\$

4,037,389

\$

4,105,387

**TOTAL ASSETS**

\$  
9,385,741  
\$  
9,500,728

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

**CONDENSED CONSOLIDATED BALANCE SHEETS (CONTINUED)**

**LIABILITIES AND STOCKHOLDERS' EQUITY**

(Unaudited)  
September 30,  
2010

December 31,  
2009

**CURRENT LIABILITIES**

Accounts payable

\$  
295,403

\$  
103,726

Commissions payable

	1,187,195
	1,115,134
Other current liabilities	
	69,677
	54,765
Current portion of long-term debt	
	277,910
	278,117
Total current liabilities	
	\$
	1,830,185

\$  
1,551,742

**LONG-TERM LIABILITIES**

Notes payable

\$  
333,525

\$  
307,902

Convertible promissory note

950,000

950,000

Other long-term liabilities

290,545

475,157

Less current portion of long-term debt

(277,910)

(278,117)

Total long-term liabilities

\$

1,296,160

\$

1,454,942

**TOTAL LIABILITIES**

\$  
3,126,345  
\$  
3,006,684

**STOCKHOLDERS' EQUITY**

Series A preferred stock—5,000,000 shares authorized, \$.0001 par value;

\$  
305  
\$  
305

3,050,000 and 3,050,000 shares issued and outstanding, respectively



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;

1,446

1,446

14,455,943 and 14,455,943 shares issued and outstanding, respectively

Additional paid in capital—common stock

10,446,301

10,396,335

Accumulated deficit

(5,713,351)

(5,428,737)

**TOTAL STOCKHOLDERS' EQUITY**

\$  
6,259,396  
\$  
6,494,044

**TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY**

\$  
9,385,741  
\$  
9,500,728

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)  
Three Months Ended  
September 30,

2010

2009

**OPERATING REVENUES**

Fee income

\$

218,121

\$

279,041

Commissions

4,337,266

4,089,281

Interest and other income

158,875

220,195

Total revenue

\$

4,714,262

\$

4,588,517

**OPERATING EXPENSES**

Compensation and benefits

\$

331,148

\$

512,904

Commission expense

4,073,956

3,816,019

General and administrative expenses

341,528

233,543

Geological and geophysical costs

16,711

Depreciation and amortization

13,999

23,125

Total operating expenses

\$

4,777,342

\$

4,585,591

**OPERATING INCOME (LOSS)**

\$  
(63,080)  
\$  
2,926

**OTHER EXPENSES**

Interest expense

\$  
(20,198)  
\$  
(58,151)

**LOSS OF CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE**

\$

(83,278)

%

(55,225)

**INCOME TAX BENEFIT**

9,476

21,648

**NET LOSS BEFORE DISCONTINUED OPERATIONS**

\$

(73,802)



\$  
(33,577)

**DISCONTINUED OPERATIONS**

Loss on sale of mutual fund segment

\$  
(81,140)

\$

—

Loss from operation of discontinued mutual fund segment (net of tax)

—

(158,919)

Total discontinued operations

\$

(81,140)

\$

(158,919)

**NET LOSS**

\$

(154,942)

\$

(192,496)

**NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

\$

(.01)

\$

(.01)

Diluted

\$

(.01)

\$

(.01)

**SHARES USED IN COMPUTING NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

14,638,937

14,535,059

Diluted

14,638,937

14,535,059

**NET LOSS PER COMMON SHARE:**

Basic

\$

(.01)

\$

(.01)

Diluted

\$

(.01)

\$

(.01)

**SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:**

Basic

14,638,937

14,535,059

Diluted

14,638,937

14,535,059

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)  
Nine Months Ended  
September 30,

2010

2009

**OPERATING REVENUES**

Fee income

\$

723,471

\$

784,061

Commissions

13,222,033

12,104,112

Interest and other income

459,944

429,986

Total revenue

\$

14,405,448

\$

13,318,159

**OPERATING EXPENSES**



Compensation and benefits

\$

1,011,630

\$

1,362,071

Commission expense

12,424,730

11,306,291

General and administrative expenses

822,179

783,269

Geological and geophysical costs

21,951

Depreciation and amortization

57,959

79,146

Total operating expenses

\$

14,338,449

\$

13,530,777

**OPERATING INCOME (LOSS)**

\$  
66,999  
\$  
(212,618)

**OTHER EXPENSES**

Interest expense

\$  
(60,857)  
\$  
(191,874)

**INCOME (LOSS) OF CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE**

\$

6,142

\$

(404,492)

**INCOME TAX BENEFIT (EXPENSE)**

(140,992)

158,561

**NET LOSS BEFORE DISCONTINUED OPERATIONS**

\$

(134,850)

\$  
(245,931)

**DISCONTINUED OPERATIONS**

Loss on sale of mutual fund segment

\$  
(81,140)

\$

—

Income from operation of discontinued mutual fund segment (net of tax

—

114,793

Total discontinued operations

\$

(81,140)

\$

114,793

**NET LOSS**

\$

(215,990)

\$

(131,138)

**NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

\$

(.01)

\$

(.01)

Diluted

\$

(.01)

\$

(.01)

**SHARES USED IN COMPUTING NET LOSS OF CONTINUING OPERATIONS PER COMMON SHARE:**

Basic

14,638,937

14,531,573

Diluted

14,638,937

14,531,573

**NET LOSS PER COMMON SHARE:**



Basic

\$

(.02)

\$

(.01)

Diluted

\$

(.02)

\$

(.01)

**SHARES USED IN COMPUTING NET LOSS PER COMMON SHARE:**

Basic

14,638,937

14,531,573

Diluted

14,638,937

14,531,573

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(Unaudited)  
Nine Months Ended  
September 30,

2010

2009

**CASH FLOWS FROM OPERATING ACTIVITIES**

Net loss

\$  
(215,990)  
\$  
(131,138)

Adjustments to reconcile net loss to net cash provided (used) by operating activities:

Depreciation and amortization

57,958

79,146

Gain on allocation of ESOP Shares

—

(2,812)

Loss on disposal of fixed assets

—

67,860

(Gain) loss on disposal of discontinued operations

81,140

52

(228,402)

(Increase) decrease in:

Accounts receivable

(96,594)

379,622

Deferred income asset

63,291

427,103

Income taxes receivable

103,071

(137,261)

Prepays

(12,469)

48,905

Other assets

(31,483)

(44,510)

Increase (decrease) in:

Accounts payable

	191,676
	(265,836)
Commissions payable	
	72,061
	(22,967)
Other liabilities	
	14,912
	(183,894)
Net cash provided (used) by operating activities	
	\$
	227,573
	\$
	(14,184)
	55

**CASH FLOWS FROM FINANCING ACTIVITIES**

Reduction of long-term liability

\$

(58,445)

\$

(63,450)

Increase of notes payable

25,624

(19,219)

Redemption and call of sub. corp notes



	—
	(2,000,000)
Repayments from ESOP	
	—
	5,020
Preferred dividends paid	
	(68,625)
	(68,625)
Net cash used by financing activities	
	\$
	(101,446)
	\$
	(2,143,274)

**NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS**

\$  
184,868  
\$  
(653,568)

**CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR**

\$  
1,968,738  
\$  
2,840,108

**CASH AND CASH EQUIVALENTS AT END OF PERIOD**

\$  
2,153,606  
\$  
2,186,540

**SUPPLEMENTAL SCHEDULE OF NONCASH  
INVESTING AND FINANCING ACTIVITIES:**

Increase (decrease) in long-term receivable

\$  
(81,140)  
\$  
762,740

Decrease in goodwill

76,200

85,050

Decrease in other long-term liabilities

126,167

142,147

Decrease in common stock

49,967

57,097

Preferred stock dividends declared

22,875

22,875

SEE NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## **CAPITAL FINANCIAL HOLDINGS, INC., AND SUBSIDIARIES**

### **NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

**September 30, 2010 and 2009**

#### **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, 2009, of Capital Financial Holdings, Inc., as filed with the SEC. The condensed consolidated balance sheet at December 31, 2009, 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.

The company has elected to use the Successful Efforts accounting method for the oil and gas division. Under this method, all expenses related to geological and geophysical operations are fully expensed on the income statement of the company, and all acquisition costs, i.e., lease costs, are capitalized on the company's balance sheet.

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 six months ended September 30, 2010, 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 F-10 through F-11 of our 2009 Form 10-K.

The Company adopted Accounting Standards Codification ("ASC") 805, Business Combinations. ASC 805 generally requires an acquirer to recognize the identifiable assets acquired, liabilities assumed, contingent purchase consideration and any noncontrolling interest in the acquiree at fair value on the date of acquisition. It also requires an acquirer to recognize as expense most transaction and restructuring costs as incurred, rather than include such items in the cost of the acquired entity. For the Company, ASC 805 applies prospectively to business combinations for which the acquisition date is on or after October 1, 2009. The adoption of ASC 805 did not have a material impact on the Company's condensed consolidated financial statements.

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.

In December of 2007, the FASB established new accounting and reporting standards for the non-controlling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, these new standards require the recognition of a non-controlling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the non-controlling interest will be included in consolidated

net income on the face of the income statement.

These new standards are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The adoption of these new standards has not had a significant effect on the Company's consolidated financial statements.

In December 2008, the SEC issued a final rule, "Modernization of Oil and Gas Reporting." This rule revised some of the oil and gas reporting disclosures in Regulation S-K and Regulation S-X under the Securities Act and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as well as Industry Guide 2. Effective December 31, 2009, the Financial Accounting Standards Board ("FASB") issued revised guidance that substantially aligned the oil and gas accounting disclosures with the SEC's final rule. The amendments were designed to modernize and update oil and gas disclosure requirements to align them with current practices and changes in technology. Additionally, this new accounting standard requires that entities use 12-month average natural gas and oil prices when calculating the quantities of proved reserves and performing the full-cost ceiling test calculation. The new standard also clarified that an entity's equity-method investments must be considered in determining whether it has significant oil and gas activities. The disclosure requirements were effective for registration statements filed on or after January 1, 2010 and for annual financial statements filed on or after December 31, 2009; however, the FASB provided a one-year deferral of the disclosure requirements if an entity became subject to the requirements because of a change to the definition of significant oil and gas activities. We have incurred acquisition costs and geological and geophysical costs during the nine month period ended September 30, 2010, under our wholly owned subsidiary.

### **NOTE 3—RECLASSIFICATION**

Certain amounts in the 2009 condensed consolidated financial statements have been reclassified to conform to the 2010 presentation. These reclassifications had no effect on the Company's net loss.

### **NOTE 4—INCOME TAXES**

The Company has completed various acquisitions in prior years, which have been classified as goodwill at the time of acquisition. The Company amortizes certain goodwill for tax purposes. The Company tests goodwill for impairment annually for book purposes, during the second quarter of each fiscal year. The annual test is done at the reporting unit level using a fair value approach, in accordance with the FASB accounting and reporting standards. Deferred tax assets or deferred tax liabilities may result from these timing differences.

The Company has adopted the FASB accounting and reporting standards for share-based payment (See Note 8—Stock Warrants, Stock Splits, and Stock Options.) As a result, the Company expenses stock-based employee compensation for book purposes on the grant date, but does not expense them for tax purposes until such options are exercised. Deferred tax assets are a result of these timing differences.

### **NOTE 5—BUSINESS ACQUISITIONS**

On April 22, 2005, the Company acquired the management rights to the IPS Millennium Fund and the IPS New Frontier Fund from IPS Advisory, Inc. ("IPS Advisory"), and merged them into a new Integrity Fund called the Integrity Growth & Income Fund. The two funds had combined assets of approximately \$57 million at the time of acquisition. The purchase agreement called for total consideration of approximately 656,000 common shares of the Company. The Company provided IPS Advisory with 250,000 common shares upon closing. The remaining consideration of approximately 406,000 common shares, which was subject to adjustment based on retention of assets in the fund, was to be issued as follows: 203,000 common shares at the one-year anniversary of the closing date, and 203,000 common shares at the two-year anniversary of the closing date. The shares are subject to a put option, which allows the holders of the shares to put them back to the Company at a price equal to the market price of the Company's shares as of the closing date, which was \$.36 per share. The put option is exercisable with respect to one-third of the

shares per year starting on the third anniversary of the closing date. The Company will also provide IPS Advisory with a stock option incentive bonus based on growth in assets in the Fund based on the following schedule: 150,000 options on the Company's common shares if assets of the Fund reach \$100 million and 150,000 options on the Company's common shares if the assets of the Fund reach \$200 million. The options will have a strike price of \$.65 per share and mature 10 years from the closing date. The securities issued in connection with this transaction were issued on a private placement basis. In April of 2006, the one-year anniversary payment of 158,603 common shares was made, which reflected the assets of the acquired funds at the one-year anniversary. In June of 2007, the two-year anniversary payment of 138,797 common shares was made, which reflected the assets of the acquired funds at the two-year anniversary. In April 2010 the put option mentioned above expired, which resulted in the liability of this acquisition to be reduced to \$0.

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 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. On March 7, 2007, the Company issued 500,000 restricted common shares to UHFS. As a result of this issuance of shares, \$175,000 was recorded by the Company as goodwill relating to the purchase of the assets. As of September 30, 2010, the Company had made thirteen quarterly installment payments totaling \$312,316. The liability relating to this acquisition is valued at approximately \$290,545 as of September 30, 2010, and has also been recorded by the Company as goodwill. As of September 30, 2010, the total goodwill recorded relating to this acquisition was \$876,689.

#### **NOTE 6—DISCONTINUED OPERATIONS**

On March 6, 2009, Capital Financial Holdings, Inc. (the "Company") entered into a Definitive Agreement (the "Agreement") with Corridor Investors, LLC ("Buyer"), pursuant to which Buyer agreed to purchase from Seller, and Seller agreed to sell to Buyer: (i) all of the issued and outstanding shares of each of three subsidiaries of the Company, Integrity Fund Services, Inc., a share transfer agency, Integrity Funds Distributor, Inc., a FINRA member broker dealer and Integrity Mutual Funds, Inc. of Nevada, a non-operating entity (the "Companies"); (ii) all of Seller's right, title and interest in and to certain tangible assets and (iii) the sale of certain assets of Integrity Money Management, Inc. related to its mutual fund advisory business. The purpose of the Agreement was to facilitate a change in advisor as well as to transfer, together with the operating subsidiaries, the combined mutual fund service business of the Seller currently provided to The Integrity Funds, Integrity Managed Portfolios, ND Tax-Free Fund, Inc., Montana Tax-Free Fund, Inc. and Integrity Fund of Funds, Inc. ("the Funds"), which are investment companies registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940. As of July 31, 2009, the required Fund shareholder approval from the various Funds had been received to consummate the change in advisor along with the transfer of the mutual fund service to the Buyer. As per the Agreement, at closing on July 31, 2009, the Buyer paid \$1,525,480 (60 BPS of the aggregate net assets, totaling \$254,246,596 as of July 30, 2009) to the Company. The Company received \$227,200 for the first of the three installments consisting of 10 BPS of the aggregate net assets as of July 30, 2010. The Company had originally estimated this receivable at \$762,740 based on the aggregate net assets as of July 30, 2009. As of July 31, 2010, this estimate was reduced to \$681,599 due to a reduction in the net aggregate assets of the funds. The difference of \$81,140 has been reflected as a revision of this estimate and recorded as a loss on discontinued operations in the current year statement of operations. The Company will receive two additional payments consisting of 10 BPS of the aggregate net assets as of July 30, 2011 and 2012 over the next two years. With the closing and transfer of entities, the Company is no longer involved in the mutual fund service business. The Company continues to operate as a Broker-Dealer through its wholly owned subsidiary Capital Financial Services, Inc. As a result of the transfer, post closing of the transaction, Integrity Fund Services, Inc., Integrity Funds Distributor, Inc. and Integrity Money Management, Inc., which constitutes the mutual fund division of the Company, will be reflected in the Company's future consolidated financial statements as a discontinued operation.



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The results of the mutual fund segment are reported in the Company's Consolidated Statements of Operations separately as discontinued operations. In accordance with GAAP, the Consolidated Balance Sheets have not been restated.

Summarized financial information for discontinued operations is as follows:

Three Months ended  
September 30, 2010

Three Months ended  
September 30, 2009

Total revenues, net of interest expense

\$

—

\$

25,939

Gain (loss) on disposal of discontinued operations

(81,140)

(158,919)

Total gain (loss) on discontinued operations, net of tax

\$

(81,140)

\$

(158,919)

65

Nine Months ended  
September 30, 2010

Nine Months ended  
September 30, 2009

Total revenues, net of interest expense

\$

—

\$

354,328

Gain (loss) on disposal of discontinued operations

(81,140)

114,793

Total gain (loss) on discontinued operations, net of tax

\$

66

(81,140)

\$

114,793

**NOTE 7—GOODWILL**

The changes in the carrying amount of goodwill for the nine months ended September 30, 2010, are as follows:

Balance as of January 1, 2010

\$

3,431,641

Goodwill acquisition price adjustment during the period

(76,200)

Balance as of September 30, 2010

\$

3,355,441

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.

**NOTE 8—STOCK WARRANTS, STOCK SPLITS, AND STOCK OPTIONS**

In December of 2005, the Company adopted the FASB accounting and reporting standards for share-based payment, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors, including employee stock options, based on estimated fair values. There were no compensation costs or deferred tax benefits recognized for stock-based compensation awards for the nine months ended September 30, 2010 and 2009.

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Option activity for the twelve months ended December 31, 2009 and the nine months ended September 30, 2010 was as follows:

	Number of Options
Weighted Average Exercise Price per Share	
Weighted Average Grant Date Fair Value	
	Aggregate Intrinsic Value

Outstanding on January 1, 2009

5,888,113

\$

.54

\$

.28

\$

1,081,950

Granted

—

—

—

Exercised

—

—

—

Canceled

—

—

—

Outstanding on December 31, 2009

5,888,113

\$

.54

\$

.28

\$

69

—  
  
Granted

—  
  
Exercised

—  
  
Canceled

Outstanding on September 30, 2010

5,888,113

\$

.54

\$

.28

\$

—

Exercisable options at December 31, 2009 and September 30, 2010 were 5,888,113 and 5,888,113, respectively.

# **NOTE 9—DEBT**

Long-term debt at September 30, 2010 and December 31, 2009 was as follows:

Rate

Current Portion

2010

2009

First Western Bank

6.50%

31,466

285,502

307,902

Convertible promissory note

6.50%

—

950,000

950,000

IPS Acquisition

—



	49,967
Corwin note	10.00%
	48,024
	48,024
Future payments on acquisitions	
	198,420
	290,545
	425,190

Totals

\$  
277,910  
\$  
1,574,071  
\$  
1,733,059

Summaries of the terms of the long-term debt agreements follow:

**First Western Bank**—In June of 1999, the Company converted its outstanding balance of \$500,000 borrowed on its bank line-of-credit to long-term debt. The debt was refinanced in September of 2009 and currently carries an interest rate of 6.50%, with monthly payments of \$4,105. On October 1, 2014, the remaining balance will be due in full.

**Subordinate Corporate Notes**—The Company approved a \$2 million intra-state subordinate corporate note offering limiting the sale in North Dakota, to North Dakota residents only. The subordinate corporate notes did not represent ownership in the Company. On June 23, 2009 and July 30, 2009 redemptions were processed, totaling \$200,000.00 and \$300,000.00 respectively. On September 30, 2009 the Company elected pursuant to the terms of its Corporate Note obligations to call and prepay its remaining \$1,500,000 Corporate Note obligation. This amount consists of all of outstanding Corporate Notes originally due January 1, 2011. By prepaying the Corporate Notes from available cash, the current asset position of the Company was reduced by \$1,591,613 and the Corporate Note liability of the same amount was eliminated. There was no prepayment charge or other cost to the Company associated with the prepayment.

**Convertible Promissory Note**—In October of 2006, the Company issued a \$950,000 convertible promissory note to PawnMart, Inc., in a private placement. The unsecured note carries an interest rate of 6.5% per annum, payable semi-annually, and matures on October 15, 2016. The holder of the note has the right, at any time after October 15, 2009, to convert the note in whole or in part, into \$0.0001 par value common shares of the Company. The conversion price shall be equal to \$0.50 per share. The entire principal amount of this note shall be automatically converted into common shares at the conversion price on October 15, 2016.

**Future Payments on Acquisitions**—see Note 5—Business Acquisitions

**NOTE 10—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 September 30, 2010

Three Months Ended September 30, 2009

Numerator

Denominator

Per Share Amount

Numerator

Denominator

Per Share Amount

Net Loss

\$

(154,942)

\$

(192,496)

Less: Preferred Stock Dividends

(22,875)

(22,875)

Income Available to Common Shareholders—Basic Earnings per Share

\$	
	(177,817)
	14,638,937
\$	
(.01)	
\$	
	(215,371)
	14,535,059
\$	
(.01)	

Effect of Dilutive Securities:

Convertible Promissory Note Interest (net of taxes)

—  
—

Preferred Stock Dividends

Stock Options and Warrants

Income Available to Common Shareholders—Diluted Earnings per Share

\$

(177,817)

14,638,937

\$

(.01)

\$

(215,371)

14,535,059

\$

(.01)

Nine Months Ended September 30, 2010

Nine Months Ended September 30, 2009

Numerator

Denominator

Per Share Amount

Numerator

Denominator

Per Share Amount

Net Loss



\$		(215,990)
\$		(131,138)
Less: Preferred Stock Dividends		(68,625)
		(68,625)
Income Available to Common Shareholders—Basic Earnings per Share		
\$		(284,615)
		14,638,937
\$		

(.02)

\$

(199,763)

14,531,573

\$

(.01)

Effect of Dilutive Securities:

Convertible Promissory Note Interest (net of taxes)

—

—

—

—

Preferred Stock Dividends

—  
—

—  
—

Stock Options and Warrants

—  
—

—  
—

Income Available to Common Shareholders—Diluted Earnings per Share

\$

(284,615)

14,638,937

\$

(.02)

\$

(199,763)

14,531,573

\$

(.01)

Options and warrants to purchase 8,486,113 common shares at exercise prices between \$0.35 and \$1.43 were outstanding at September 30, 2010, but were not included in the computation of diluted earnings per share for the quarter ending September 30, 2010, because their effect was anti-dilutive.

The Company had outstanding, at September 30, 2010, 3,050,000 Series A preferred shares. The preferred shares are entitled to receive a cumulative dividend at a rate of 6% per year, payable quarterly. The preferred shares are convertible to the Company's common shares at the rate of one share of common shares for one share of Series A preferred shares at any time after issuance.

The Series A preferred shares were not included in the computation of diluted earnings per share for the quarter ended September 30, 2010, because their effect was anti-dilutive.

Additionally, the Company had outstanding at September 30, 2010, a \$950,000 convertible promissory note. The unsecured note carries an interest rate of 6.5% per year, payable semi-annually, and matures on October 15, 2016. The holder of the note has the right, at any time after October 15, 2009, to convert the note in whole or in part, into common shares of the Company at a conversion price of \$0.50 per share. The entire principal amount of this note shall be automatically converted into common shares at the conversion price on October 15, 2016.

The convertible promissory note was not included in the computation of diluted earnings per share for the quarter and nine-month periods ended September 30, 2010 because the conversion price was greater than the average market price of the common shares during those periods.

#### **NOTE 11—FAIR VALUE DISCLOSURES**

FASB ASC 820 defines fair value, establishes 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, as specified by FASB ASC 820, 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 will allow CFS to sell the investment to the General Managing Partner of the limited partnership; and this feature will become available three years from the date of the first income distribution, which was December of 2007. The fair market value of this \$76,876 investment is estimated to be \$45,000 based on discounted cash flows; however this amount could fluctuate with the prices of oil and natural gas. CFS will continue to carry the investment on its books at the \$45,000 value until the "presentment" feature can be utilized.

Carrying Value at September 30, 2010

Quarter and nine months ended  
September 30, 2010

Total

Level 1

Level 2

Level 3

Total Losses

Other Investment

\$

45,000

\$

—

\$  
—  
\$  
45,000  
\$  
—

## NOTE 12—SUBSEQUENT EVENTS

No significant events have occurred subsequent to the Company's quarter-end. Subsequent events have been evaluated through November 12, 2010, which is the date these financial statements were issued.

### 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 organizes its current business units into two reportable segments: broker-dealer services and oil and gas activities. The broker-dealer services segment distributes securities and insurance products to retail investors through a network of registered representatives. The oil and gas activities segment will seek opportunities in petroleum and natural gas exploration and production.

The Company's reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies.

### Segment Information

As of, and for the three months ended:

Holding  
Company

Oil & Gas  
Activities

Broker-Dealer  
Services

Total

**September 30, 2010**

Revenues from external customers

\$

35,340

\$

88



	945
	\$
	4,677,977
	\$
	4,714,262
Inter-segment revenues	
	—
	—
	—
	—
Interest expense	
	20,198
	—
	—
	20,198
Depreciation and amortization	
	10,697
	89

	(3,516)
	6,818
	13,999
Income (loss) before income tax benefit (expense)	
	(97,731)
	(31,113)
	45,566
	(83,278)
Income tax benefit (expense)	
	14,476
	12,000
	(17,000)
	9,476
Net income (loss) before discontinued operations	

	(83,255)
	(19,113)
	28,566
	(73,802)
Discontinued operations	
	(81,140)
	—
	—
	(81,140)
Net income (loss) after discontinued operations	
	(164,395)
	(19,113)
	28,566
	(154,942)
Segment assets	

		7,013,673
		979,324
		2,471,136
		10,464,133
Expenditure for segment assets		
		3,090
		2,612
		1,644
		7,346
As of, and for the three months ended:		
	Holding Company	
	Oil & Gas Activities	

Broker-Dealer  
Services

Total

September 30, 2009

Revenues from external customers

\$

19,529

\$

	—
	\$
	4,568,988
	\$
	4,588,517
Inter-segment revenues	
	(5,788)
	—
	5,788
	5,788
Interest expense	
	58,151
	—
	—
	58,151
Depreciation and amortization	
	16,782
	94

	—
	6,343
	23,125
Income (loss) before income tax benefit (expense)	
	(367,251)
	—
	312,026
	(55,225)
Income tax benefit (expense)	
	143,948
	—
	(122,300)
	21,648
Net loss before discontinued operations	

	(223,303)
	—
	189,726
	(33,577)
Discontinued operations	
	(158,919)
	—
	—
	(158,919)
Net income (loss) after discontinued operations	
	(382,222)
	—
	189,726
	(192,496)
Segment assets	



		7,366,662	
		—	
		2,327,797	
		9,694,459	
Expenditure for segment assets			
		13,193	
		—	
		—	
		13,193	
As of, and for the nine months ended:			
	Holding Company		
	Oil & Gas Activities		

Broker-Dealer  
Services

Total

**September 30, 2010**

Revenues from external customers

\$

142,073

\$

	2,741
	\$
	14,260,634
	\$
	14,405,448
Inter-segment revenues	
	(1,081)
	—
	1,081
	1,081
Interest expense	
	60,857
	—
	—
	60,857
Depreciation and amortization	
	37,442
	99

	131
	20,386
	57,959
Income (loss) before income tax benefit (expense)	
	(372,442)
	(68,700)
	447,273
	6,142
Income tax benefit (expense)	
	7,008
	27,000
	(175,000)
	(140,992)
Net income (loss) before discontinued operations	

	(365,423)
	(41,700)
	272,273
	(134,850)
Discontinued operations	
	(81,140)
	—
	—
	(81,140)
Net income (loss) after discontinued operations	
	(446,563)
	(41,700)
	272,273
	(215,990)
Segment assets	

		7,013,673
		979,324
		2,471,136
		10,464,133
Expenditure for segment assets		
		3,090
		2,612
		10,373
		16,075
As of, and for the nine months ended:		
	Holding Company	
	Oil & Gas Activities	

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Broker-Dealer  
Services

Total

September 30, 2009

Revenues from external customers

\$

19,054

\$

103

	—
	\$
	13,299,105
	\$
	13,318,159
Inter-segment revenues	
	(25,364)
	—
	25,364
	25,364
Interest expense	
	191,874
	—
	—
	191,874
Depreciation and amortization	
	60,555
	104



	—
	18,591
	79,146
Income (loss) before income tax benefit (expense)	
	(881,530)
	—
	477,038
	(404,492)
Income tax benefit (expense)	
	345,561
	—
	(187,000)
	158,561
Net income (loss) before discontinued operations	

	(535,969)
	—
	290,038
	(245,931)
Discontinued operations	
	114,793
	—
	—
	114,793
Net income (loss) after discontinued operations	
	(421,176)
	—
	290,038
	(131,138)
Segment assets	

7,366,662

—

2,327,797

9,694,459

Expenditure for segment assets

14,206

—

4,383

18,589

**Reconciliation of Segment Information**

For the Three Months Ended

September 30, 2010

September 30, 2009

Revenues:

Total revenues for reportable segments

\$

4,714,262

\$

4,594,305

Elimination of inter-company revenues

—

(5,788)

Consolidated total revenues

\$

4,714,262

\$

4,588,517

Profit:

Total reportable segment income

\$

(154,942)

\$

(192,496)

Assets:

Total assets for reportable segments

\$

10,464,133

\$

9,772,851

Elimination of inter-company receivables

(1,078,392)

(78,392)

109

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Consolidated assets

\$

9,385,741

\$

9,694,459

For the Nine Months Ended

September 30, 2010

September 30, 2009

Revenues:

Total revenues for reportable segments

\$

14,406,529

\$

13,343,523

Elimination of inter-company revenues

(1,081)

(25,364)

110

Consolidated total revenues

\$

14,405,448

\$

13,318,159

Profit:

Total reportable segment income (loss)

\$

(215,990)

\$

(131,138)

Assets:

Total assets for reportable segments

\$

10,464,133

\$

9,772,851

Elimination of inter-company receivables

(1,078,392)

(78,392)

Consolidated assets

\$

9,385,741

\$

9,694,459

## RESULTS OF OPERATIONS

Three Months Ended  
September 30,

Nine Months Ended  
June 30,



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2010

2009

2010

2009

Net loss

\$

(154,942)

\$

(192,496)

\$

(215,990)

\$

(131,138)

Income per share:

Basic

\$

(.01)

\$	
	(.01)
\$	
	(.02)
\$	
	(.01)
Diluted	
\$	
	(.01)
\$	
	(.01)
\$	
	(.02)
\$	
	(.01)

The Company reported a net loss for the quarter ended September 30, 2010, of \$154,942, compared to a net loss of \$192,496 for the same quarter in 2009. The Company reported a net loss for the nine months ended September 30, 2010 of \$215,990, compared to a net loss of \$131,138 for the same period in 2009.

### **Operating revenues**

Total operating revenues for the quarter ended September 30, 2010 were \$4,714,262, an increase of 3% from \$4,588,517 for the quarter ended September 30, 2009. Total operating revenues for the nine months ended September 30, 2010 were \$14,405,448, an increase of 8% from \$13,318,159 for the nine months ended September 30, 2009. The increases for the quarter and nine-month periods resulted primarily from increased commission income received by CFS.

### ***Fee Income***

Fee income for the quarter ended September 30, 2010 was \$218,121, a decrease of 22% from \$279,041 for the quarter ended September 30, 2009. Fee income for the nine months ended September 30, 2010 was \$723,471, a decrease of 8% from \$784,061 for the nine months ended September 30, 2009. The decreases were due to a reduction 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 5% of the Company's consolidated revenues for the nine months ended September 30, 2010.

### ***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 September 30, 2010 was \$4,337,266, an increase of 6% from \$4,089,281 for the quarter ended September 30, 2009. Commission income for the nine months ended September 30, 2010 was \$13,222,033, an increase of 9% from \$12,104,112 for the nine months ended September 30, 2009. The increases were due primarily to an increase in commissions received by CFS due to market conditions. Future market conditions will continue to impact commission levels. Commission revenues constituted 92% of the Company's consolidated revenues for the nine months ended September 30, 2010.

### ***Interest and other income***

Interest and other income for the quarter ended September 30, 2010 was \$158,875, a decrease of 28% from \$220,195 for the quarter ended September 30, 2009. Interest and other income for the nine months ended September 30, 2010 was \$459,944, an increase of 7% from \$429,986 for the nine months ended September 30, 2009. The decrease in the quarter was due primarily to a decrease in due diligence and marketing allowances received by CFS, and the increase in the nine month period was due to an increase in rental income of the holding company. Interest and other income constituted 3% of the Company's consolidated revenues for the nine months ended September 30, 2010.

### ***Operating expenses***

Total operating expenses for the quarter ended September 30, 2010 were \$4,777,342, an increase of 4% from \$4,585,591 for the quarter ended September 30, 2009. Total operating expenses for the nine months ended September 30, 2010 were \$14,338,449, an increase of 6% from \$13,530,777 for the nine months ended September 30, 2009. The increases resulted from the net increases in the expense categories described in the paragraphs below.

The table below displays the expenses relating to the Oil and Gas activities for the three and nine month periods ending September 30, 2010:

Three Months ended September 30,	
2010	
2009	
Geological and geophysical expenses	\$
	16,711
	\$
	—

Depreciation expense

\$  
(3,516)

\$  
—

General and administrative expenses

\$  
(1,969)

\$  
—

Compensation and benefit expenses

\$  
20,833

\$  
—

Total oil and gas expenses

\$  
32,059

\$  
—

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Nine Months ended  
September 30,

2010

2009

Geological and geophysical expenses

\$

21,951

\$

—

Depreciation expense

\$

131,2861

\$

—

General and administrative expenses

\$

46,499

\$

—

Compensation and benefit expenses

\$

71,442

\$

—

Total oil and gas expenses

\$

\$

***Compensation and benefits***

Compensation and benefits expense for the quarter ended September 30, 2010 was \$331,148, a decrease of 35% from \$512,904 for the quarter ended September 30, 2009. Compensation and benefits expense for the nine months ended September 30, 2010 was \$1,011,630, a decrease of 26% from \$1,362,071 for the nine months ended September 30, 2009. The decreases resulted primarily from a reduction in the number of employees over the past twelve months.

***Commission expense***

Commission expense for the quarter ended September 30, 2010 was \$4,073,956, an increase of 7% from \$3,816,019 for the quarter ended September 30, 2009. Commission expense for the nine months ended September 30, 2010 was \$12,424,730, an increase of 10% from \$11,306,291 for the nine months ended September 30, 2009. The increases in commission expense correspond with the increases in commission income.

***General and administrative expense***

Total general and administrative expenses for the quarter ended September 30, 2010 were \$341,528, an increase of 46% from \$233,543 for the quarter ended September 30, 2009. Total general and administrative expenses for the nine months ended September 30, 2010 were \$822,179, an increase of 5% from \$783,269 for the nine months ended September 30, 2009. The increases were due primarily to an increase in CFS' licensing fees, legal fees, and fees paid to outside parties for IT services performed.

***Geological and Geophysical Costs***

Total Geological & Geophysical costs for the quarter ended September 30, 2010 were \$16,711, and increase of 100% from \$0 for the quarter ended September 30, 2009. Total G&G costs for the nine months ended September 30, 2010 were \$21,951, and increase from 100% from \$0 for the nine months ended September 30, 2009. The increase was due to the oil and gas division being opened in February of 2010.

***Depreciation and amortization***

Depreciation and amortization expense for the quarter ended September 30, 2010 was \$13,999, a decrease of 39% from \$23,125 for the quarter ended September 30, 2009. Depreciation and amortization expense for the nine months ended September 30, 2010 was \$57,959, a decrease of 27% from \$79,146 for the nine months ended September 30, 2009. The decrease for the quarter and nine-month period was due to the disposal of assets associated with the mutual fund division.

The table below displays the capitalized costs relating to the Oil & Gas activities for the three and nine month periods ending September 30, 2010:

Capitalized Costs Relating to the Oil and Gas Producing Activities for the  
three months ended September 30,

2010

2009

Unproved oil and gas properties

\$

81,732

\$

—

Proved oil and gas

\$

—

\$

—

Accumulated depreciation and amortization

\$

(3,516)

\$

—

Net capitalized costs

\$

78,216

119

\$

—

Capitalized Costs Relating to the Oil and Gas Producing Activities for the  
nine months ended September 30,

2010

2009

Unproved oil and gas properties

\$

154,996

\$

—

Proved oil and gas

\$

—

\$

—

Accumulated depreciation and amortization

\$



(131)

\$

Net capitalized costs

\$

154,865

\$

### Liquidity and capital resources

Net cash provided by operating activities was \$227,573 for the nine months ended September 30, 2010, as compared to net cash used by operating activities of \$14,184 during the nine months ended September 30, 2009. The primary difference corresponds with the increase in the commissions and fee income due to market conditions.

Net cash provided by investing activities was \$58,741 for the nine months ended September 30, 2010, compared to net cash provided by investing activities of \$1,506,891 for the nine months ended September 30, 2009. During the nine months ended September 30, 2010, the cash provided by investing activities was received from Corridor Investors, LLC, based off their aggregate net assets, as discussed in Note 6—Discontinued Operations.

Net cash used by financing activities was \$101,446 for the nine months ended September 30, 2010, compared to net cash used by financing activities of \$2,146,274 for the nine months ended September 30, 2009. During the nine months ended September 30, 2010, the Company paid out \$68,625 in preferred stock dividends, made three payments totaling \$58,445 relating to the United Heritage acquisition (see Note 5—Business Acquisitions) and repaid \$22,400 of bank debt.

At September 30, 2010, the Company held \$2,153,606 in cash and cash equivalents, as compared to \$1,968,738 at December 31, 2009. The Company is required to maintain certain levels of cash and liquid securities in CFS to meet regulatory net capital requirements.

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 to acquire additional financial services firms, broker recruitment, asset acquisition opportunities for the Company's new oil and gas operations subsidiary, repurchase shares of the Company's common stock, and service debt. Management also expects to realize increases in expenses associated with regulatory compliance with Section 404 of the Sarbanes-Oxley Act of 2002, including increased legal, audit, staff, and 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.

Until July 31, 2009 the Company derived substantially all of its revenues from two sources; commission revenue earned in connection with sales of shares of mutual funds, insurance products, and various other securities and fees relating to management of, and provision of services to mutual funds. Following the disposition of the Mutual Fund Services Segment, the Company has two operating subsidiaries, Capital Financial Services, Inc. ("CFS" or the "broker-dealer subsidiary") a FINRA member broker-dealer and Capital Energy Resources, Inc. ("CER" or the "oil and gas subsidiary").

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 representatives' customers. In the past, investment advisory services were performed by both Capital Financial Services, Inc. on an individual client basis and Integrity Money Management, Inc. on behalf of the mutual fund segment; services through Integrity Money Management, Inc. were discontinued as a result of the disposition of the Mutual Funds Service Segment effective July 31, 2009.

A key component of the broker-dealer subsidiaries' 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.

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.

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.

### **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-15(e) and Rule 15d-15(e) 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 September 30, 2010, 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.

There were no significant changes in the Company's internal controls over financial reporting during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **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, including a number of investigatory matters and legal proceedings arising out of customer allegations related to past commissioned sales of alternative investment products. In 2007 through the first quarter of 2009 a substantial amount (approximately 10% to 20%) of the Company's sales of commissioned products were in private placements of alternative products, two of which as of December 31, 2009 (Medical Capital Corporation and related issuer entities and Provident Royalties, LLC. and related issuer entities) were placed in receivership by action of the United States Securities and Exchange Commission and issuers of certain other alternative products sold by the Company are in Chapter 11 Bankruptcy or may have financial difficulties. Additionally, difficult economic conditions in general and the stock market decline have contributed to decline in broker-dealer subsidiary client portfolio values. 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 regulatory scrutiny and a number of recently instituted legal or arbitration proceedings, including two recently instituted proceedings seeking certification as class actions which name the Company as one of a number of defendants and allege various securities or conduct violations, one with respect to private placements of Medical Capital Corporation and related issuer entities for which the broker-dealer subsidiary placed approximately \$100 million of debt securities and the other with regard to private placements of Provident Royalties, LLC and related issuer entities for which the broker-dealer subsidiary placed approximately \$60 million of debt securities. The Company intends to vigorously contest 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 a range of loss that may result.

### **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:***

#### **Period**



**Total Number of Shares Purchased**

**Average Price Per Share**

**Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs**

**Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs**

July 2010

—

—

—

\$597,754

August 2010

—

—

—

\$597,754

September 2010

—

—

—

\$597,754

Total

—

—

—

\$597,754

**Item 3.**

**Defaults Upon Senior Securities**

None

**Item 4.**

**Submission of Matters to a Vote of Security Holders**

None

**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

**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: November 12, 2010

By:

/s/ Jacqueline L. Case

Jacqueline L. Case

Interim President and Executive Officer

(Principal Executive Officer)

Date: November 12, 2010

By:

/s/ Valarie A. Hoskin

Valarie A. Hoskin

Chief Financial Officer

(Principal Financial Officer)