

Merriman Holdings, Inc  
Form 10-Q  
November 14, 2014

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
<sup>X</sup>ACT OF 1934.**

For the quarterly period ended September 30, 2014

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

For the Transition Period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number: 1-15831

**MERRIMAN HOLDINGS, INC.**

(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

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

**250 Montgomery Street, 16th Floor**  
**San Francisco, CA** **94104**  
**(Address of Principal Executive Offices) (Zip Code)**

**(415) 248-5603**

**(Registrant's Telephone Number, Including Area Code)**

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

Indicate by check mark whether the registrant 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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 definition 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

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

The number of shares of Registrant's common stock outstanding as of November 7, 2014 was 4,518,633.

**Merriman Holdings, Inc.**

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**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements (unaudited)****MERRIMAN HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

|                                      | Three Months Ended September 30, |              | Nine Months Ended September 30, |              |
|--------------------------------------|----------------------------------|--------------|---------------------------------|--------------|
|                                      | 2014                             | 2013         | 2014                            | 2013         |
| Revenues                             |                                  |              |                                 |              |
| Commissions                          | \$ 1,182,564                     | \$ 1,057,800 | \$ 3,781,037                    | \$ 3,276,160 |
| Principal transactions               | (72,833 )                        | (96,157 )    | 693,722                         | (60,779 )    |
| Investment banking                   | 2,742,111                        | 484,650      | 7,508,092                       | 1,546,344    |
| Advisory and other                   | 607,950                          | 483,041      | 1,658,008                       | 1,629,559    |
| Total revenues                       | \$ 4,459,792                     | \$ 1,929,334 | \$ 13,640,859                   | \$ 6,391,284 |
| Operating expenses                   |                                  |              |                                 |              |
| Compensation and benefits            | \$ 4,121,905                     | \$ 1,531,207 | \$ 10,065,468                   | \$ 5,530,637 |
| Brokerage and clearing fees          | 69,590                           | 95,218       | 333,020                         | 297,994      |
| Professional services                | 108,011                          | 113,329      | 369,684                         | 260,583      |
| Occupancy and equipment              | 258,705                          | 358,058      | 853,125                         | 1,051,354    |
| Communications and technology        | 217,361                          | 194,667      | 603,281                         | 537,942      |
| Depreciation and amortization        | 43,839                           | 39,899       | 126,498                         | 46,900       |
| Travel and entertainment             | 63,558                           | 60,605       | 199,086                         | 166,241      |
| Legal services and settlement        | 10,418                           | 303,601      | 38,344                          | 369,645      |
| Cost of underwriting capital         | -                                | -            | -                               | 49,600       |
| Other                                | 252,705                          | 328,115      | 837,509                         | 895,618      |
| Total operating expenses             | 5,146,092                        | 3,024,699    | 13,426,015                      | 9,206,514    |
| Operating income/(loss)              | (686,300 )                       | (1,095,365 ) | 214,844                         | (2,815,230 ) |
| Interest expense                     | (99,486 )                        | (81,849 )    | (280,157 )                      | (247,328 )   |
| Amortization of debt discount        | (6,755 )                         | (35,370 )    | (33,046 )                       | (109,561 )   |
| Loss on debt modification            | (9,023 )                         | -            | (271,322 )                      | -            |
| Loss on early extinguishment of debt | -                                | -            | -                               | (293,347 )   |

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|  |               |                 |               |                 |
|--|---------------|-----------------|---------------|-----------------|
| Net loss before income tax               | (801,564 )    | (1,212,584 )    | (369,681 )    | (3,465,466 )    |
| Income tax expense                       | -             | (2,737 )        | -             | (11,999 )       |
| Net loss                                 | \$ (801,564 ) | \$ (1,215,321 ) | \$ (369,681 ) | \$ (3,477,465 ) |
| Basic and diluted net loss per share     | \$ (0.18 )    | \$ (0.31 )      | \$ (0.08 )    | \$ (1.30 )      |
| Weighted average number of common shares |               |                 |               |                 |
| Basic and diluted                        | 4,516,410     | 3,965,261       | 4,388,746     | 2,685,148       |

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

**MERRIMAN HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(unaudited)**

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| <b>ASSETS</b>  |                       |                      |
| Cash and cash equivalents  | \$365,466             | \$1,044,110          |
| Securities owned   |                       |                      |
| Marketable, at fair value  | 949,509               | 1,176,347            |
| Not readily marketable, at estimated fair value  | 1,840,255             | 671,801              |
| Restricted cash  | 649,153               | 891,828              |
| Due from clearing broker   | 42,150                | 97,811               |
| Accounts receivable, net   | 459,477               | 532,431              |
| Prepaid expenses and other assets  | 1,378,486             | 674,915              |
| Equipment and fixtures, net  | 317,995               | 341,258              |
| <b>Total assets</b>  | <b>\$6,002,491</b>    | <b>\$5,430,501</b>   |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>  |                       |                      |
| <b>Liabilities</b>   |                       |                      |
| Accounts payable   | \$115,551             | \$317,272            |
| Commissions payable  | 228,384               | 418,075              |
| Accrued expenses and other   | 772,760               | 814,946              |
| Deferred rent  | 549,092               | 428,540              |
| Deferred revenue   | 94,202                | 70,378               |
| Capital lease obligations  | 291,138               | 360,795              |
| Notes payable, net of debt discount  | 720,000               | 1,226,521            |
| Notes payable to related parties, net of debt discount   | 2,293,140             | 1,940,601            |
| <b>Total liabilities</b>   | <b>5,064,267</b>      | <b>5,577,128</b>     |
| <b>Shareholders' equity (deficit)</b>  |                       |                      |
| Convertible preferred stock, Series A—\$0.0001 par value; 2,000,000 shares authorized; 2,000,000 shares issued and 0 shares outstanding as of September 30, 2014 and December 31, 2013; aggregate liquidation preference of \$0  | -                     | -                    |
| Convertible preferred stock, Series B—\$0.0001 par value; 12,500,000 shares authorized; 8,750,000 shares issued and 0 shares outstanding as of September 30, 2014 and December 31, 2013; aggregate liquidation preference of \$0 | -                     | -                    |
| Convertible preferred stock, Series C—\$0.0001 par value; 14,200,000 shares authorized; 11,800,000 shares issued and 0 shares outstanding as of September 30,  | -                     | -                    |

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2014 and December 31, 2013; aggregate liquidation preference of \$0

Convertible preferred stock, Series D—\$0.0001 par value; 24,000,000 shares authorized, 23,720,916 shares issued and 0 shares outstanding as of September 30, 2014 and December 31, 2013; aggregate liquidation preference of \$0 prior to conversion, and pari passu with common stock on conversion

Convertible Preferred stock, Series E—\$0.0001 par value; 7,300,000 shares authorized, 6,825,433 shares issued and 0 shares outstanding as of September 30, 2014 and December 31, 2013; aggregate liquidation preference of \$0 prior to conversion, and pari passu with common stock on conversion

|  |               |               |
|--|---------------|---------------|
| Common stock, \$0.0001 par value; 7,300,000 shares authorized; 4,519,614 and 4,141,838 shares issued and 4,518,633 and 4,140,857 shares outstanding as of September 30, 2014 and December 31, 2013, respectively | 452           | 414           |
| Additional paid-in capital   | 150,441,918   | 148,987,424   |
| Treasury stock   | (225,613 )    | (225,613 )    |
| Accumulated deficit  | (149,278,533) | (148,908,852) |
| Total shareholders' equity (deficit)   | 938,224       | (146,627 )    |
| Total liabilities and shareholders' equity (deficit)   | \$6,002,491   | \$5,430,501   |

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

**MERRIMAN HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY****FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2014****(unaudited)**

|   | Common Stock |        | Treasury Stock |             | Additional         | Accumulated     | Total       |
|---|--------------|--------|----------------|-------------|--------------------|-----------------|-------------|
|   | Shares       | Amount | Shares         | Amount      | Paid-in<br>Capital | Deficit         |             |
| Balance at January 1, 2014  | 4,141,838    | \$ 414 | (981)          | \$(225,613) | \$148,987,424      | \$(148,908,852) | \$(146,627) |
| Net loss  |              |        |                |             |                    | (369,681)       | (369,681)   |
| Issuance of restricted common stock and warrants for cash         | 377,776      | 38     |                |             | 677,606            |                 | 677,644     |
| Issuance of warrants in connection with letter of credit guaranty |              |        |                |             | 45,933             |                 | 45,933      |
| Issuance of warrants in connection with debt modification         |              |        |                |             | 271,322            |                 | 271,322     |
| Stock-based compensation  | -            | -      | -              | -           | 459,633            | -               | 459,633     |
| Balance at September 30, 2014                                     | 4,519,614    | \$ 452 | (981)          | \$(225,613) | \$150,441,918      | \$(149,278,533) | \$938,224   |

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



**MERRIMAN HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

|   | Nine Months Ended September 30, |                   |
|---|---------------------------------|-------------------|
|   | 2014                            | 2013              |
| Cash flows from operating activities:   |                                 |                   |
| Net loss  | \$ (369,681                     | ) \$ (3,477,465 ) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                                 |                   |
| Depreciation and amortization   | 126,498                         | 30,622            |
| Stock-based compensation  | 459,633                         | 554,326           |
| Amortization of debt issuance costs   | 33,046                          | 109,561           |
| Loss on restructuring of debt   | 271,322                         | -                 |
| Loss on early extinguishment of debt  | -                               | 293,347           |
| Provision for uncollectible accounts receivable   | 160,250                         | 152,429           |
| Securities received for services  | (1,718,005                      | ) (354,087 )      |
| Unrealized loss on securities owned   | 397,608                         | 113,683           |
| Changes in operating assets and liabilities:  |                                 |                   |
| Securities owned  | 378,781                         | (310,182 )        |
| Restricted cash   | 242,674                         | (211,800 )        |
| Due from clearing broker  | 55,661                          | (41,055 )         |
| Accounts receivable   | (87,295                         | ) 45,643          |
| Prepaid expenses and other assets   | (73,265                         | ) (217,612 )      |
| Accounts payable  | (201,721                        | ) (60,498 )       |
| Commissions payable   | (189,691                        | ) (281,263 )      |
| Accrued expenses and other  | 102,189                         | 118,045           |
| Net cash used in operating activities   | (411,996                        | ) (3,536,306 )    |
| Cash flows from investing activities:   |                                 |                   |
| Purchase of software platform   | (120,371                        | ) -               |
| Purchase of equipment and fixtures  | (103,235                        | ) (1,319 )        |
| Net cash used in investing activities   | (223,606                        | ) (1,319 )        |
| Cash flows from financing activities:   |                                 |                   |
| Proceeds from issuance of restricted common stock   | 677,643                         | 1,962,375         |
| Proceeds from issuance of secured promissory note   | -                               | 166,028           |
| Proceeds from issuance of secured convertible promissory note                             | -                               | 600,000           |
| Proceeds from issuance of unsecured convertible promissory note                           | 85,000                          | -                 |
| Payments of notes payable   | (736,028                        | ) -               |
| Proceeds from issuance of temporary subordinated borrowings                               | -                               | 1,600,000         |

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|  |            |              |
|--|------------|--------------|
| Payment of temporary subordinated borrowings         | -          | (1,600,000 ) |
| Principal payments of capital leases                 | (69,657 )  | -            |
| Net cash provided by (used in) financing activities  | (43,042 )  | 2,728,403    |
| Increase in cash and cash equivalents                | (678,644 ) | (809,222 )   |
| Cash and cash equivalents at beginning of the period | 1,044,110  | 1,316,990    |
| Cash and cash equivalents at end of the period       | \$ 365,466 | \$ 507,768   |

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

**MERRIMAN HOLDINGS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – (continued)**

**(unaudited)**

Supplementary disclosure of cash flow information:

Cash paid during the year:

|                              |           |           |
|------------------------------|-----------|-----------|
| Cost of underwriting capital | \$-       | \$49,600  |
| Interest expense             | \$223,512 | \$186,427 |

Non-cash financing activities

|  |     |             |
|--|-----|-------------|
| Issuance of restricted common stock in connection with debt conversion | \$- | \$1,210,000 |
| Property and equipment acquired through capital leases                 | \$- | \$327,379   |

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

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**1. Description of Business**

Merriman Holdings, Inc. and subsidiaries (the Company) is a financial services holding company that provides capital markets advisory and research, corporate and investment banking services through its wholly-owned operating subsidiary, Merriman Capital, Inc. (hereafter MC). MC is an investment bank and securities broker-dealer whose clients are fast growing public and private companies and the entrepreneurs who manage those companies. MC facilitates efficient capital formation through a proprietary digital network (DCN). MC is registered with the Securities and Exchange Commission (SEC) as a broker-dealer and is a member of the Financial Industry Regulatory Authority (FINRA) and Securities Investor Protection Corporation (SIPC).

The Company is a Delaware corporation incorporated on May 6, 1987. The Company's common stock is listed on the OTCQX where it currently trades under the symbol "MERR." Its corporate office is located in San Francisco, CA.

*Basis of Presentation*

The accompanying condensed consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States (U.S. GAAP). For the purposes of presentation, dollar amounts displayed in these Notes to Condensed Consolidated Financial Statements were rounded to the nearest thousand.

The Company's interim unaudited condensed consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the SEC. In the opinion of management, the condensed consolidated financial statements included in this report reflect all normal recurring adjustments that the Company considers necessary for the fair presentation of the consolidated results of operations for the interim periods covered and the consolidated financial condition of the Company at the date of the interim statements of financial condition. Certain information and footnote disclosures normally included in annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, the Company believes all adjustments (consisting of normal recurring accruals) considered necessary to make the unaudited condensed consolidated financial statements not misleading have been included. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These condensed consolidated financial statements should be read in conjunction with the Company's 2013 audited

consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K and on Form 10-K/A for the year ended December 31, 2013.

## **2. Liquidity/Going Concern**

The Company incurred a net loss of \$370,000 and had negative operating cash flows of \$412,000 during the nine months ending September 30, 2014. It also incurred substantial losses in 2013, having net losses of \$3,992,000 and negative operating cash flows of \$2,836,000. As of September 30, 2014, the Company had an accumulated deficit of \$149,278,000. These facts raise substantial doubt as to the Company's ability to continue as a going concern.

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business and do not include any adjustments that might result from uncertainty about the Company's ability to continue as a going concern.

The Company's continued existence is also dependent upon its ability to increase revenues generated from operations that will enable the Company to achieve a profitable level of operations.

If anticipated operating results are not achieved, management has the intent, and believes it has the ability, to further delay or reduce expenditures. In such case, the further reduction in operating expenses might need to be substantial. Failure to generate sufficient cash flows from operations, raise additional capital, or reduce certain discretionary spending would have a material adverse effect on the Company's ability to achieve its intended business objectives. The Company can give no assurance that it will be successful in its plans and can give no assurance that additional financing will be available on terms advantageous to the existing terms or that additional financing will be available at all. Should the Company not be successful in obtaining the necessary financing to fund its operations, the Company would need to curtail certain or all of its operational activities, reduce costs or contemplate the sale of its assets if necessary.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(unaudited)**

**3. Summary of Significant Accounting Policies**

*Use of Estimates*

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

*Stock-Based Compensation Expense*

The Company measures and recognizes compensation expense based on estimated fair values for all stock-based awards made to employees and directors, including stock options, restricted stock, and warrants. The Company estimates fair value of stock-based awards on the date of grant using the Black-Scholes option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense in the Company's condensed consolidated statements of operations over the requisite service periods. Because stock-based compensation expense is based on awards that are ultimately expected to vest, stock-based compensation expense has been reduced to account for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

To calculate stock-based compensation resulting from the issuance of options, restricted common stock, and warrants, the Company uses the Black-Scholes option pricing model, which is affected by the Company's stock price as well as assumptions regarding a number of subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. No tax benefits were attributed to the share-based compensation expense because a valuation allowance was maintained for all net deferred tax assets.

The Company used the Market Approach to arrive at an estimated fair value of the Company's common stock used in the Black-Scholes option pricing model to determine the fair value of the option grants made during the three and nine

months ended September 30, 2014.

The market approach is based on the economic principle of competition (i.e., in a free market, forces of demand and supply will direct the values of businesses to a particular balance). Valuation under the Market Approach entails the application of appropriate market-based multiples selected from guideline public companies (GPCs) to parameters such as level of earnings, cash flow, revenues, invested capital or other financial factors (financial metrics) that represent the subject company's future financial performance. This method is based on the idea of determination of the price at which the company will be exchanged in the public market, and is particularly useful for valuing companies that are currently profitable and expected to continue making profits in the foreseeable future.

Under the Market Approach, we used the following methods:

- Observable inputs from the trading of its common stock on OTCQX;
- Guidelines Public Companies' Trading Multiples Method ("GPC");
- Back Solve approach.

To apply the Back Solve approach, the Company determined that it is appropriate to use the Black Scholes option valuation model as the primary method for allocating the Company's equity value. The Company gave 50% weight each to the equity value arrived from the GPC and Back Solve approaches.

### ***Earnings (Loss) Per Share***

Basic earnings (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding, excluding shares of non-vested stock. Diluted income per share is calculated by dividing net income by the weighted average number of common shares used in the basic income per share calculation plus the number of common shares that would be issued assuming exercise or conversion of all potentially dilutive common shares outstanding, including non-vested stock. Diluted loss per share is unchanged from basic loss per share because the addition of common shares that would be issued assuming exercise or conversion would be anti-dilutive. Interests for convertible debt are also not considered since including them in the calculation of diluted loss per share would be anti-dilutive.

**MERRIMAN HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(unaudited)***Earnings (Loss) Per Share – continued*

The following table sets forth the components used in the computation of basic and dilutive earnings (loss) per common share:

|   | September 30, |           |
|---|---------------|-----------|
|   | 2014          | 2013      |
| Series D convertible preferred stock warrants               | 112,927       | 112,955   |
| Series E convertible preferred stock warrants               | 113,741       | 113,757   |
| Stock options   | 882,134       | 426,548   |
| Warrants issued in connection with Secured Promissory Notes | 13,495        | 16,420    |
| Warrants issued in connection with recapitalization         | 1,164,530     | 1,167,325 |
| Other outstanding warrants                                  | 272,940       | 25,309    |
| Potentially dilutive securities outstanding                 | 2,559,767     | 1,862,314 |

For the three and nine months ended September 30, 2014, 6,186,923 and 6,218,957 common share equivalents for the potential warrant and option exercises and conversion of convertible notes were excluded from the calculation of dilutive earnings per share since its inclusion would have been anti-dilutive, respectively. For the three and nine months ended September 30, 2013, 5,327,280 and 5,621,927 common share equivalents for the potential warrant and option exercises and conversion of convertible notes were excluded from the calculation of dilutive earnings per share since its inclusion would have been anti-dilutive, respectively.

*Adoption of New Accounting Pronouncements*

In August 2014, the FASB issued a new accounting standard which requires management to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for each annual and interim reporting period. If substantial doubt exists, additional disclosure is required. This new standard will be effective for the Company for annual and interim periods beginning after December 15, 2016. Early adoption is permitted. The Company expects to adopt this new standard for the fiscal year ending December 31, 2016 and the Company will continue to assess the impact on its condensed consolidated financial statements.



The FASB has issued ASU No. 2014-12 Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. This ASU requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company is currently evaluating the effect of the ASU on its financial position, results of operations and cash flows.

The FASB has issued ASU No. 2014-09, Revenue from Contracts with Customers. This ASU supercedes the revenue recognition requirements in Accounting Standards Codification 605 - Revenue Recognition and most industry-specific guidance throughout the Codification. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. This ASU is effective on January 1, 2017 and should be applied retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying the ASU recognized at the date of initial application. The Company is currently evaluating the effect of the ASU on its financial position, results of operations and cash flows.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**3. Summary of Significant Accounting Policies – continued**

*Securities Owned*

Securities owned and securities sold, not yet purchased in the condensed consolidated statements of financial condition consist of financial instruments carried at fair value with related unrealized gains or losses recognized in principal transactions in the consolidated statement of operations. The securities owned are classified into “Marketable” and “Non-marketable.” Marketable securities are those that can readily be sold, either through a stock exchange or through a direct sales arrangement. Non-marketable securities are typically securities restricted under the Federal Securities Act of 1933 provided by SEC Rule 144 (Rule 144) or have some restriction on their sale whether or not a buyer is identified.

*Fair Value of Financial Instruments*

Substantially all of the Company’s financial instruments are recorded at fair value or contract amounts that approximate fair value. The carrying amounts of the Company’s financial instruments, which include cash and cash equivalents, restricted cash, due from clearing broker, accounts receivable, accounts payable, commissions and bonus payable, accrued expenses and other, securities sold, not yet purchased, deferred revenue, and capital lease obligation, approximate their fair values.

*Fair Value Measurement—Definition and Hierarchy*

The Company follows the provisions of ASC 820, *Fair Value Measurement and Disclosures*, for its financial assets and liabilities. Under ASC 820, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (*i.e.*, the “exit price”) in an orderly transaction between market participants at the measurement date.

Where available, fair value is based on observable market prices or parameters, or derived from such prices or parameters. Where observable prices or inputs are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments or market and the instruments' complexity. Assets and liabilities recorded at fair value in the consolidated statement of financial condition are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Hierarchical levels, defined by ASC 820 and directly related to the amount of subjectivity associated with the inputs to fair valuation of these assets and liabilities, are as follows:

Level 1 — Unadjusted, quoted prices are available in active markets for identical assets or liabilities at the measurement date. The types of assets and liabilities carried at Level 1 fair value generally are G-7 government and agency securities, equities listed in active markets, investments in publicly traded mutual funds with quoted market prices and listed derivatives.

Level 2 — Pricing inputs (other than quoted prices included in Level 1) are either directly or indirectly observable for the asset or liability through correlation with market data at the measurement date and for the duration of the instrument's anticipated life. Fair valued assets which are generally included in this category are stock warrants for which market-based implied volatilities are available, and unregistered common stock.

Level 3 — Pricing inputs are both significant to the fair value measurement and unobservable. These inputs generally reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date. Consideration is given to the risk inherent in the valuation technique and the risk inherent in the inputs to the model. Fair valued assets which are generally included in this category are stock warrants for which market-based implied volatilities are not available.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, for disclosure purposes, the level in the fair value hierarchy within which the fair value measurement falls in its entirety is determined based on the lowest level input that is significant to the fair value measurement in its entirety.

For further information on financial assets and liabilities that are measured at fair value on a recurring and nonrecurring basis, and a description of valuation techniques, see Note 4.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**3. Summary of Significant Accounting Policies – continued**

*Concentrations and Credit Risk*

Substantially all of the Company's cash and cash equivalents are held at two major U.S. financial institutions. The majority of the Company's cash equivalents consist of short-term marketable securities. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand.

As of September 30, 2014 and December 31, 2013, the Company held concentrated positions in three securities with total fair values of \$839,000 and \$1,092,000. The prices of these securities are highly volatile.

As of September 30, 2014 and December 31, 2013, the Company did not hold concentrated positions in accounts receivable with any one client that exceeded 10% of total accounts receivable.

During the three and nine months ended September 30, 2014, one sales professional accounted for more than 10% of total revenue (approximately \$697,000 and \$2,365,000 in the aggregate) and no customer accounted for more than 10% of total revenue. During the three and nine months ended September 30, 2013, one and two sales professionals who each accounted for more than 10% of total revenue (approximately \$684,000 and \$2,426,000 in the aggregate), respectively, and one customer accounted for more than 10% of total revenue (approximately \$217,000 and \$731,000 in the aggregate).

During the three and nine months ended September 30, 2014, two and one investment banking clients accounted for more than 10% of our total revenues, respectively. During the three and nine months ended September 30, 2013, no investment banking client accounted for more than 10% of our total revenues.

The Company is also exposed to credit risk as it relates to the collection of receivables from third parties, including lead managers in underwriting transactions and the Company's corporate clients related to private placements of securities and financial advisory services.

***Subsequent Events***

The Company has evaluated all subsequent events through the date these condensed consolidated financial statements were issued. (See Note 12)

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**4. Fair Value of Assets and Liabilities**

Fair value is defined as the price at which an asset would sell for or an amount paid to transfer a liability in an orderly transaction between market participants at the measurement date (the exit price). Where available, fair value is based on observable market prices or parameters or derived from such prices or parameters. Where observable prices or parameters are not available, valuation models are applied. These valuation techniques involve some level of management estimation and judgment, the degree of which is dependent on the price transparency for the instruments or the market on which they are primarily traded, and the instruments' complexity. Assets and liabilities recorded at fair value in the consolidated statements of financial condition are categorized based upon the level of judgment associated with the inputs used to measure their fair value.

The Company has categorized its assets and liabilities at fair value based upon the following fair value hierarchy:

a) Level 1 inputs which utilize quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs which utilize other-than-quoted prices that are observable, either directly or indirectly. Level 2 inputs b) include quoted prices for similar assets and liabilities in active markets, and inputs such as interest rates and other information that are observable at commonly quoted intervals.

c) Level 3 inputs which are unobservable and are typically based on assumptions, including situations where there is little, if any, market activity.

A description of the valuation techniques applied to the Company's major categories of assets and liabilities measured at fair value on a recurring basis follows.

***Corporate Equities***

Corporate equities are comprised primarily of exchange-traded equity securities that the Company takes selective proprietary positions based on expectations of future market movements and conditions.

Also, as compensation for investment banking services, the Company frequently receives common stock of the client as an additional compensation to cash fees. The common stock is typically issued prior to a registration statement becoming effective. The Company classifies these securities as “not readily marketable securities” as they are restricted stock and may be freely traded only upon the effectiveness of a registration statement covering them or upon the satisfaction of the requirements to qualify under the exemption to Rule 144, including the requisite holding period. Once a registration statement covering the securities is declared effective by the SEC or the securities have satisfied the Rule 144 requirements, the Company classifies them as “marketable securities.”

Typically, the common stock is traded on stock exchanges and most are classified as Level 1 securities. The fair value is based on the observed closing stock price at the measurement date. As of September 30, 2014, the fair value of this type of securities included in securities owned in the statements of financial condition is approximately \$950,000.

Certain securities are traded infrequently and therefore do not have observable prices based on actively traded markets. These securities are classified as Level 3 securities, if pricing inputs or adjustments are both significant to the fair value measurement and unobservable. The Company determines the fair value of infrequently trading securities using the observed closing price at measurement date, discounted for the put option value calculated through the Black-Scholes model or similar valuation techniques. Valuation inputs used in the Black-Scholes model include observable inputs such as interest rate, expected term and market price of the underlying stock, in addition to unobservable inputs such as stock volatility.

As of September 30, 2014, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately \$183,000.

### ***Stock Warrants***

Also as partial compensation for investment banking services, the Company may receive stock warrants issued by the client. If the underlying stock of the warrants is freely tradable, the warrants are considered to be marketable. If the underlying stock is restricted, subject to a registration statement or to satisfying the requirements for a Rule 144 exemption, the warrants are considered to be non-marketable. Such positions are considered illiquid and do not have readily determinable fair values, and therefore require significant management judgment or estimation.

The fair value of the stock warrants is determined using the Black-Scholes model or similar valuation techniques. Valuation inputs used in the Black-Scholes model include observable inputs such as interest rate, expected term and market price of the underlying stock, in addition to unobservable inputs such as stock volatility. Generally, a change in

stock volatility results in a directionally similar change in fair value. As these require significant management assumptions, they are classified as Level 3 securities.

As of September 30, 2014, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately \$1,657,000.



**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**4. Fair Value of Assets and Liabilities – continued**

*Underwriters' Purchase Options*

The Company may receive partial compensation for its investment banking services also in the form of underwriters' purchase options ("UPOs"). UPOs are identical to warrants other than with respect to the securities for which they are exercisable. UPOs grant the holder the right to purchase a "bundle" of securities, including common stock and warrants to purchase common stock. UPOs grant the right to purchase securities of companies for which the Company acted as an underwriter to account for any overallotment of these securities in a public offering. Such positions are considered illiquid and do not have readily determinable fair values, and therefore require significant management judgment or estimation.

The fair value of the UPO is determined using the Black-Scholes model or similar technique, applied in two stages. The first stage is to determine the value of the warrants contained within the "bundle" which is then added to the fair value of the stock within the bundle. Once the fair value of the underlying "bundle" is established, the Black-Scholes model is used again to estimate a value for the UPO. The fair value of the "bundle" as estimated by Black-Scholes in the first stage is used instead of the price of the underlying stock as one of the inputs in the second stage of the Black-Scholes. Valuation inputs used in the Black-Scholes model include observable inputs such as interest rate; stock expected term and market price of the underlying stock, in addition to unobservable inputs such as stock volatility. Generally, a change in stock volatility results in a directionally similar change in fair value. The use of the valuation techniques requires significant management assumptions and therefore UPOs are classified as Level 3 securities.

As of September 30, 2014, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately \$0.

*Preferred Stock*

Preferred stock represents preferred equity in companies. The preferred stock owned by the Company is convertible at the Company's discretion. For these securities, the Company uses the exchange-quoted price of the common stock equivalents to value the securities. They are classified within Level 2 or Level 3 of the fair value hierarchy depending on the availability of an observable stock price on actively traded markets.

As of September 30, 2014, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately \$0.

***Securities Sold, Not Yet Purchased***

Securities sold, not yet purchased are comprised primarily of exchange-traded equity securities that the Company sold short based on expectations of future market movements and conditions. They are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied and they are categorized in Level 1 liability of the fair value hierarchy.

The following table summarizes quantitative information about the significant unobservable inputs used in the fair value measurement of the Company's Level 3 financial instruments:

|  | Valuation Technique                | Unobservable Input | Range    | Weighted Average |   |
|--|------------------------------------|--------------------|----------|------------------|---|
| Financial instruments and other inventory positions owned: |                                    |                    |          |                  |   |
| Stock warrants   | Black-Scholes option pricing model | Stock volatility   | 3 - 350% | 168              | % |

**MERRIMAN HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(unaudited)****4. Fair Value of Assets and Liabilities — continued**

Assets and liabilities measured at fair value on a recurring basis are summarized below:

|                               | Assets at Fair Value at September 30, 2014 |         |              |              |
|-------------------------------|--|---------|--------------|--------------|
|                               | Level 1                                    | Level 2 | Level 3      | Total        |
| Assets:                       |  |         |              |              |
| Corporate equities            | \$ 949,509                                 | \$ -    | \$ 183,173   | \$ 1,132,682 |
| Stock warrants                | -  | -       | 1,657,082    | 1,657,082    |
| Underwriters' purchase option | -  | -       | -            | -            |
| Preferred stock               | -  | -       | -            | -            |
| Total securities owned        | \$ 949,509                                 | \$ -    | \$ 1,840,255 | \$ 2,789,764 |

The following summarizes the change in carrying values associated with Level 3 financial instruments for the nine months ended September 30, 2014:

|  | Corporate<br>Equities | Stock<br>Warrants | Underwriters'<br>Purchase<br>Options | Preferred Stock | Total        |
|--|-----------------------|-------------------|--------------------------------------|-----------------|--------------|
| Balance at December 31, 2013   | \$ 78,756             | \$ 568,756        | \$ 24,056                            | \$ 234          | \$ 671,802   |
| Purchases or receipt (a)   | 188,750               | 1,125,945         | -                                    | -               | 1,314,695    |
| Sales or exercises   | -                     | (57 )             | -                                    | -               | (57 )        |
| Transfers out of Gains (losses):   | (61,758 )             | -                 | -                                    | -               | (61,758 )    |
| Realized   | -                     | -                 | -                                    | -               | -            |
| Unrealized   | (22,575 )             | (37,562 )         | (24,056 )                            | (234 )          | (84,427 )    |
| Balance at September 30, 2014  | \$ 183,173            | \$ 1,657,082      | \$ -                                 | \$ -            | \$ 1,840,255 |
| Change in unrealized gains (losses) relating to instruments still held at September 30, 2014 | \$(22,575 )           | \$(37,562 )       | \$(24,056 )                          | \$(234 )        | \$(84,427 )  |

(a) Includes purchases of securities and securities received for services

Net gains and losses (both realized and unrealized) for Level 3 financial assets are a component of principal transactions in the condensed consolidated statements of operations.

***Transfers within the Fair Value Hierarchy***

The Company assesses its financial instruments on a quarterly basis to determine the appropriate classification within the fair value hierarchy. Transfers between fair value classifications occur when there are changes in pricing observability levels. Transfers of financial instruments among the levels occur at the end of the reporting period.

**MERRIMAN HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(unaudited)****5. Issuance of Debt**

Notes Payable as of September 30, 2014 comprise of the following:

|                            | Notes Payable | Notes Payable<br>Related Party | Total        |
|----------------------------|---------------|--------------------------------|--------------|
| Subordinated notes payable | \$ 170,000    | \$ 1,570,600                   | \$ 1,740,600 |
| Debt discount              | -             | -                              | -            |
|                            | 170,000       | 1,570,600                      | 1,740,600    |
| Secured promissory notes   | 550,000       | 750,000                        | 1,300,000    |
| Debt discount              | -             | (27,460 )                      | (27,460 )    |
|                            | 550,000       | 722,540                        | 1,272,540    |
| Total                      | \$ 720,000    | \$ 2,293,140                   | \$ 3,013,140 |

***Unsecured Promissory Notes***

Of the \$1,570,600 Unsecured Promissory Notes, \$840,000 was loaned from the Co Chairman of the Board of Directors, Ronald L. Chez. On September 29, 2013, the principal, together with \$201,600 accrued interest were consolidated into an Unsecured Promissory Note maturing on March 29, 2014. The new note bears interest at nine percent (9%) per annum payable monthly and five percent (5%) per annum payable at maturity. On March 27, 2014, the terms of the \$1,041,600 Unsecured Promissory Note were modified for the note to mature on December 31, 2014 at the same interest rates plus warrants to purchase 111,190 shares of the Company's common stock at \$2.40 per share.

The Company accounted for this transaction as a modification of debt, whereby a gain or loss was calculated as the difference between the fair value of the modified debt and net carrying value of the old debt. The fair value of the modified debt was determined as the sum of the face value of the debt and fair value of the warrants using the Black-Scholes fair value model. For the nine months ended September 30, 2014, a loss of approximately \$262,000 was recorded on the transaction, representing the fair value of the warrants.

For the three and nine months ended September 30, 2014, interest expenses incurred on this Unsecured Promissory Note were \$36,000 and \$109,000, respectively. Total interests of \$47,000 and \$56,000 remain outstanding as of September 30, 2014 and December 31, 2013, respectively, and are included in accrued expenses and other in the condensed consolidated statements of financial condition.

*Secured Demand Notes*

On June 30, 2014, MC entered into two three-year secured demand notes with the Company's Chief Executive Officer and a director of the Company, Dennis G. Schmal, in the amount of \$100,000 and \$364,000, respectively. The notes bear interest at 8% per annum, payable quarterly. The notes comply with FINRA's prescribed regulations and are accounted for as equity subordination in accordance with SEC Rule 15c3-1(d). The notes are subordinated to the claims of present and future creditors of MC and cannot be repaid, if such repayment will cause MC to fail to meet its minimum net capital requirements in accordance with SEC Rule 15c3-1.

The notes and their corresponding liabilities are included prepaid expenses and other assets and notes payable to related parties, respectively, in the condensed consolidated statements of financial condition.

For the three and nine months ended September 30, 2014, interest expenses incurred on these secured demand notes were \$9,000 and \$9,000, respectively. Total interests of \$9,000 remain outstanding as of September 30, 2014 and are included in accrued expenses and other in the condensed consolidated statements of financial condition.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**5. Issuance of Debt — continued**

*Unsecured Convertible Promissory Notes*

On November 1, 2013, the Company's Chief Executive Officer loaned \$30,000 to the Company in an unsecured convertible promissory note maturing on April 1, 2014. The note bears interest rate at five percent (5%) per annum payable at maturity. At any time following the date of issue and prior to repayment, the outstanding principal and accrued interest are convertible to common shares of the Company at \$1.80 per share. On March 30, 2014, the maturity date was extended to December 31, 2014 under the same terms.

On January 10, 2014, a common shareholder loaned \$50,000 to the Company in the form of an unsecured convertible promissory notes maturing on January 10, 2016. The note bears interest rates at five percent (5%) per annum payable at maturity. At any time following the date of issue and prior to repayment, the outstanding principal and accrued interest are convertible to common shares of the Company at \$1.80 per share.

On January 15, 2014, a common shareholder who is also an employee loaned \$35,000 to the Company in an unsecured convertible promissory note maturing on January 15, 2016. The note bears interest rate at five percent (5%) per annum payable at maturity. At any time following the date of issue and prior to repayment, the outstanding principal and accrued interest are convertible to common shares of the Company at \$1.80 per share.

*Secured Promissory Notes*

(a) On December 13, 2012, an unrelated party loaned \$300,000 to the Company in a secured promissory note maturing on September 13, 2013 and bearing interest rate at eight percent (8%) per annum payable at maturity. The note was extended several times and several principal payments were made. The remaining principal and accrued interest were paid in full on April 3, 2014.

- (b) As of September 30, 2014, \$550,000 principal balance of the secured promissory notes remained outstanding and was included in notes payable in the Company's condensed consolidated statement of financial condition.

## 6. Shareholders' Equity

### *Reverse Stock Split*

The Company announced a reverse stock split which became effective on July 14, 2014. The ratio of the reverse stock split is 1-for-30 shares of the Company's issued and outstanding common stock. Accordingly, each 30 shares of common stock have been converted into one share of common stock.

The condensed consolidated financial statements have been restated to reflect the reverse stock split for all periods presented herein.

### *Issuance of Common Stock Warrants for Letter of Credit Guaranty*

On June 26, 2014 and August 28, 2014, the Company issued to its Co-Chairman of the Board of Directors, Ronald L. Chez, warrants to purchase 16,042 and 15,901 shares of its common stock at \$2.40 and \$1.998 per shares, respectively. The warrants expire on the fifth anniversary of the original issue dates and were issued in consideration of Mr. Chez' guaranty of the Company's letter of credit supporting its San Francisco lease.

The warrants were valued at \$46,000 using the Black-Scholes fair value model. The warrant value is amortized over the remaining term of the lease and included in other assets in the condensed consolidated statements of financial condition.



**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**6. Shareholders' Equity— continued**

*Sale of Common Stock*

On March 12, 2014, the Company issued 27,777 shares of common stock at \$1.80 per share and 6,944 warrants for total proceeds of \$50,000. The total proceeds of \$50,000 is accounted for as an issuance of common stock with warrants and was allocated to the individual instruments based on the relative fair value of each instrument at the time of issuance. Based on such allocation method, the values allocated to common stock and warrants were \$40,000 and \$10,000, respectively.

In April 2014, the Company issued 347,217 shares of common stock at \$1.80 per share and 86,803 warrants for total proceeds of \$625,000. The total proceeds of \$625,000 is accounted for as an issuance of common stock with warrants and was allocated to the individual instruments based on the relative fair value of each instrument at the time of issuance. Based on such allocation method, the values allocated to common stock and warrants were \$504,000 and \$121,000, respectively.

**7. Stock-based Compensation Expense**

During the three and nine months ended September 30, 2014, the Company granted 409,600 and 462,927 options to purchase common shares at exercise prices of \$1.50 and \$3.30 and \$4.20, respectively. The options vest in 4 years and have a fair value of \$588,000 and \$690,000, respectively.

The fair value of employee grants is estimated on the date of grant using the Black-Scholes option pricing model. Key weighted average assumptions used to apply this pricing model were as follows:

|                     |         |
|---------------------|---------|
| Expected Volatility | 208.45% |
|---------------------|---------|

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|                               |        |
|-------------------------------|--------|
| Average expected term (years) | 3.74   |
| Risk-free interest rate       | 1.24 % |
| Dividend yield                | -      |

Compensation expense for stock options during the three and nine months ended September 30, 2014 was approximately \$258,000 and \$460,000, respectively. As of September 30, 2014, total unrecognized compensation expense related to unvested stock options was approximately \$599,000. This amount is expected to be recognized as expense over a weighted-average period of 2.60 years.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

(unaudited)

**8. Regulatory Requirements**

MC is a broker-dealer subject to Rule 15c3-1 of the SEC which specifies uniform minimum net capital requirements, as defined, for their registrants. As of September 30, 2014, MC had regulatory net capital, as defined, of approximately \$537,000 which exceeded the amount required by approximately \$287,000. MC complies with the alternative net capital requirement allowed in Appendix E of Rule 15c3-1. MC is exempt from Rules 15c3-3 and 17a-13 under the Securities Exchange Act of 1934 because it does not carry customer accounts nor does it hold customer securities or cash.

Under its rules, FINRA may prohibit a member firm from expanding its business or paying dividends if resulting net capital would be less than 5 percent of aggregate debit balances. Advances to affiliates, repayment of subordinated debt, dividend payments and other equity withdrawals by MC are subject to certain notification and other provisions of the SEC and FINRA rules. In addition, MC is subject to certain notification requirements related to withdrawals of excess net capital.

**9. Litigation and Contingencies**

Certain conditions may exist as of the date the condensed consolidated financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company assesses such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company, or unasserted claims that may result in such proceedings, the Company evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's condensed consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability and an estimate of the range of possible losses, if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed, unless they involve guarantees, in which case the guarantees would be disclosed. There can be no assurance that such matters will not materially and adversely affect the Company's business, financial position, and results of operations or cash flows.

From time to time, the Company is involved in ordinary routine litigation incidental to our business. Currently, there is no litigation against the Company. For the three and nine months ended September 30, 2014 and 2013, the Company incurred legal services and settlement of \$10,000 and \$304,000, and \$38,000 and \$370,000, respectively.

## **10. Related Party Transactions**

### ***Issuance of Common Stock Warrants for Letter of Credit Guaranty***

On June 26, 2014 and August 28, 2014, the Company issued to its Co-Chairman of the Board of Directors, Ronald L. Chez, warrants to purchase 16,042 and 15,901 shares of its common stock at \$2.40 and \$1.998 per shares, respectively. The warrants expire on the fifth anniversary of the original issue dates and were issued in consideration of Mr. Chez' guaranty of the Company's letter of credit supporting its San Francisco lease.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**10. Related Party Transactions — continued**

*Unsecured Promissory Notes*

Of the \$1,570,600 Unsecured Promissory Notes, \$840,000 was loaned from the Co Chairman of the Board of Directors, Ronald L. Chez. On September 29, 2013, the principal, together with \$201,600 accrued interest were rolled into an Unsecured Promissory Note maturing on March 29, 2014. The new note bears interest at nine percent (9%) per annum payable monthly and five percent (5%) per annum payable at maturity. On March 27, 2014, the terms of the \$1,041,600 Unsecured Promissory Note were modified for the note to mature on December 31, 2014 at the same interest rates plus warrants to purchase 111,190 shares of the Company's common stock at \$2.40 per share.

The Company accounted for this transaction as a modification of debt, whereby a gain or loss was calculated as the difference between the fair value of the modified debt and net carrying value of the old debt. The fair value of the modified debt was determined as the sum of the face value of the debt and fair value of the warrants using the Black-Scholes fair value model. For the nine months ended September 30, 2014, a loss of approximately \$262,000 was recorded on the transaction, representing the fair value of the warrants.

For the three and nine months ended September 30, 2014, interest expenses incurred on this Unsecured Promissory Note were \$36,000 and \$109,000, respectively. Total interests of \$47,000 and \$56,000 remain outstanding as of September 30, 2014 and December 31, 2013, respectively, and are included in accrued expenses and other in the condensed consolidated statements of financial condition.

*Secured Demand Notes*

On June 30, 2014, MC entered into two three-year secured demand notes with the Company's Chief Executive Officer and a director of the Company, Dennis G. Schmal, in the amount of \$100,000 and \$364,000, respectively. The notes bear interest at 8% per annum, payable quarterly. The notes comply with FINRA's prescribed regulations and are accounted for as equity subordination in accordance with SEC Rule 15c3-1(d). The notes are subordinated to the

claims of present and future creditors of MC and cannot be repaid, if such repayment will cause MC to fail to meet its minimum net capital requirements in accordance with SEC Rule 15c3-1.

The notes and their corresponding liabilities are included prepaid expenses and other assets and notes payable to related parties, respectively, in the condensed consolidated statements of financial condition.

For the three and nine months ended September 30, 2014, interest expenses incurred on these secured demand notes were \$9,000 and \$9,000, respectively. Total interests of \$9,000 remain outstanding as of September 30, 2014 and are included in accrued expenses and other in the condensed consolidated statements of financial condition.

#### *Unsecured Convertible Promissory Notes*

On November 1, 2013, the Company's Chief Executive Officer loaned \$30,000 to the Company in an unsecured convertible promissory note maturing on April 1, 2014. The note bears interest rate at five percent (5%) per annum payable at maturity. At any time following the date of issue and prior to repayment, the outstanding principal and accrued interest are convertible to common shares of the Company at \$1.80 per share. On March 30, 2014, the maturity date was extended to December 31, 2014 under the same terms.

On January 15, 2014, a common shareholder who is also an employee loaned \$35,000 to the Company in an unsecured convertible promissory note maturing on January 15, 2016. The note bears interest rate at five percent (5%) per annum payable at maturity. At any time following the date of issue and prior to repayment, the outstanding principal and accrued interest are convertible to common shares of the Company at \$1.80 per share.

**MERRIMAN HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(unaudited)**

**10. Related Party Transactions — continued**

*Software Platform Payments*

In connection with the purchase of a software platform called Digital Capital Network (“DCN”), an online capital marketplace, from an entity owned by a Board member, Robert K. Ward, the Company makes an \$18,000 ongoing monthly payment to Mr. Ward. The Company also makes a \$5,000 monthly payment to the spouse of Mr. Ward for marketing services.

*Other Related Party Transactions*

From time to time, officers and employees of the Company may invest in private placements which the Company arranges and for which the Company charges investment banking fees. The Company’s employees may, at times, provide certain services and supporting functions to its affiliate entities. The Company is not reimbursed for any costs related to providing those services.

**11. Segment Reporting**

The Company’s business results are categorized into three operating segments: MC, FEP and CMAG. The Company's reportable segments are strategic business units that offer products and services that are compatible with its core business strategy. The MC segment includes a broad range of services, such as capital raising and financial advisory services for corporate clients, and brokerage and equity research services for our institutional investor clients. The FEP segment includes capital raising services through a network of independent investment bankers and CMAG includes assisting corporate issuers in listing on OTCQX, the premier OTC Market tier, along with other services that facilitate the access to institutional capital markets.

The accounting policies of the segments are consistent with those described in the Significant Accounting Policies in Note 3. The Company evaluates segment results based on revenue and segment income. There are no revenue-generating activities between segments. Segment asset disclosures are not provided as no significant assets are separately determinable for FEP or CMAG. Revenue and expenses directly associated with each segment are included in determining segment income, which is also the internal performance measure used by management to assess the performance of each business in a given period.

Consolidation items and eliminations include the effects of eliminating transactions between operating segments, and certain non-allocated amounts. Consolidation items and elimination is not an operating segment. Rather, it is added to operating segment totals to reconcile to consolidated totals on the financial statements. Certain amounts included in consolidation items and elimination costs are not allocated to operating segments because they are excluded from the measurement of their operating performance for internal purposes. These include Board of Directors compensation, interest on general borrowings, litigation settlement costs and other charges.



**MERRIMAN HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(unaudited)****11. Segment Reporting — continued**

Management believes that the following information provides a reasonable representation of each segment's contribution to revenue and loss or operating results:

|   | Three Months Ended |               | Nine Months Ended |               |
|---|--------------------|---------------|-------------------|---------------|
|   | 30-Sep-14          | 30-Sep-13     | 30-Sep-14         | 30-Sep-13     |
| Revenues                                  |                    |               |                   |               |
| MC  | \$1,297,768        | \$1,034,488   | \$7,738,523       | \$3,987,787   |
| FEP                                       | 2,633,445          | 417,344       | 4,404,030         | 835,012       |
| CMAG                                      | 528,579            | 477,508       | 1,498,394         | 1,569,666     |
| Total segment revenues                    | 4,459,792          | 1,929,340     | 13,640,947        | 6,392,465     |
| Consolidation items and elimination       | -                  | (6)           | (88)              | (1,181)       |
| Consolidated revenues                     | \$4,459,792        | \$1,929,334   | \$13,640,859      | \$6,391,284   |
| Segment income (loss)                     |                    |               |                   |               |
| MC  | \$(1,726,162)      | \$(1,194,186) | \$(1,618,726)     | \$(3,950,159) |
| FEP                                       | 578,581            | 105,389       | 678,666           | 276,811       |
| CMAG                                      | 395,640            | 245,338       | 955,432           | 1,126,014     |
| Total segment income (loss)               | (751,941)          | (843,459)     | 15,372            | (2,547,334)   |
| Consolidation items and elimination       | (49,623)           | (369,125)     | (385,053)         | (918,132)     |
| Consolidated net loss before income taxes | \$(801,564)        | \$(1,212,584) | \$(369,681)       | \$(3,465,466) |

Substantially all of the reported revenues are from customers located in the United States and all of our long-lived assets are located in the United States.

**12. Subsequent Event*****Temporary Subordinated Borrowings***

On October 23, 2014, the Company borrowed \$300,000 from the Co-Chairman of the Board of Directors, Ronald L. Chez. The loan was in the form of a temporary subordinated loan in accordance with Rule 15c3-1 of the Securities Exchange Act of 1934.

Total fees incurred were \$7,800. The loan and related fees were paid in full on November 5, 2014.

***Secured Promissory Note***

On October 30, 2014, the Company entered into a \$100,000 one-year secured promissory note with a shareholder. The note bears interest at twelve percent (12%) per annum payable quarterly in arrears and matures on November 1, 2015. The note also includes warrants to purchase 10,000 shares of the Company's common stock at \$2.50 per share. The warrants expire on the third anniversary of the original issue date.

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

This Quarterly Report on Form 10-Q, including this Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements regarding future events and our future results that are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as “may,” “should,” “expects,” “anticipates,” “targets,” “goals,” “projects,” “intends,” “plans,” “believes,” “seeks,” “estimates,” “predicts,” “potential” or “continue,” variations of such words, and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of our future financial performance, our anticipated growth and trends in our businesses, and other characterizations of future events or circumstances, are forward-looking statements. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Readers are referred to risks and uncertainties identified under “Risk Factors” beginning on page 36 and elsewhere herein. We undertake no obligation to revise or update publicly any forward-looking statements for any reason. Numbers expressed herein may be rounded to thousands of dollars.

### Overview

Merriman Holdings, Inc. and subsidiaries (the Company) is a financial services holding company that provides capital markets advisory and research, corporate and investment banking services through its wholly-owned operating subsidiary, Merriman Capital, Inc. (hereafter MC). MC is an investment bank and securities broker-dealer whose clients are fast growing public and private companies and the entrepreneurs who manage those companies. MC facilitates efficient capital formation through a proprietary Digital Capital network (DCN). MC is registered with the Securities and Exchange Commission (SEC) as a broker-dealer and is a member of the Financial Industry Regulatory Authority (FINRA) and Securities Investor Protection Corporation (SIPC).

Our mission is to be the leader in advising, financing, trading and investing in fast-growing companies under \$1 billion in market capitalization. We originate differentiated equity research, brokerage and trading services primarily to institutional investors, as well as investment banking and advisory services to our fast-growing corporate clients.

We recognize that there is an opportunity to build an institutional quality, fully compliant platform to streamline the incredibly inefficient process of fundraising for and advising emerging companies. We have since launched the DCN, an online capital marketplace. We are now a financial technology company focused on taking a significant role in changing how high growth emerging public and private companies are funded.

With DCN, we are creating a turnkey solution for investors to screen dozens of investment opportunities across multiple investment strategies, sectors, deal sizes and locations. By increasing the number of investment opportunities available to them, institutions and family offices will be able to focus on evaluating deals rather than sourcing them. As a result, they will be able to make better investment decisions and improve the diversification of their portfolios. DCN also enables issuers with the ability to have their deals viewed immediately by dozens of qualified investors, something that previously would have taken months of travel, lengthy conference calls, and expensive road shows.

MC's Financial Entrepreneur Platform (FEP) exclusively supports highly ethical, independent investment bankers, respected research professionals and wealth managers and their clients. Many of our FEP members have recently gained independence from large and mid-tier investment banks, and are now looking for a platform where they can grow their own practice and brand within a compliant, professional and synergistic financial service environment. We currently have 30 professionals with experience in the major verticals and can advise on most structures. This variable cost model allows us to service our clients while keeping our operational expenses down.

We are headquartered in San Francisco, with an additional office in New York, NY. As of September 30, 2014, we had 32 employees.

## Executive Summary

Our total revenues were approximately \$4,460,000 and \$13,641,000 for the three and nine months ended September 30, 2014, representing a \$2,531,000 and \$7,251,000 or 131% and 113% increase over the same periods in 2013. The increases were primarily due to higher investment banking revenues and principal transactions.

For the three and nine months ended September 30, 2014, commission revenues increased 12% and 15% comparing to the same periods in 2013 due to favorable market condition. Principal transactions increased 24% and 1,241%, respectively, from the same periods in 2013 also due to favorable market condition. For the three and nine months ended September 30, 2014, investment banking revenues increased 466% and 386% over the same periods in 2013 due to more banking transactions being closed. For the three and nine months ended September 30, 2014, advisory and other revenue increased 26% and 2% over the same periods in 2013, respectively.

For the three and nine months ended September 30, 2014, net loss was \$802,000 and \$370,000 or \$0.18 and \$0.08 per share, respectively. For the three and nine months ended September 30, 2013, net loss was \$1,215,000 and \$3,477,000 or \$0.31 and \$1.30 per share, respectively. Net loss for the three and nine months ended September 30, 2014 included stock based compensation expenses of approximately \$258,000 and \$460,000, respectively. Net loss for the three and nine months ended September 30, 2013 included stock based compensation expenses of approximately (\$22,000) and \$548,000, respectively.

## Liquidity/Going Concern

The Company incurred a net loss of \$370,000 and had negative operating cash flows of \$412,000 during the nine months ending September 30, 2014. It also incurred substantial losses in 2013, having net losses of \$3,992,000 and negative operating cash flows of \$2,836,000. As of September 30, 2014, the Company had an accumulated deficit of \$149,279,000. These facts raise substantial doubt as to the Company's ability to continue as a going concern.

The accompanying condensed consolidated financial statements have been prepared assuming the Company will continue on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business and do not include any adjustments that might result from uncertainty about the Company's ability to continue as a going concern.

The Company's continued existence is also dependent upon its ability to increase revenues generated from operations that will enable the Company to achieve a profitable level of operations.

If anticipated operating results are not achieved, management has the intent, and believes it has the ability, to further delay or reduce expenditures. In such case, the further reduction in operating expenses might need to be substantial. Failure to generate sufficient cash flows from operations, raise additional capital, or reduce certain discretionary spending would have a material adverse effect on the Company's ability to achieve its intended business objectives. The Company can give no assurance that it will be successful in its plans and can give no assurance that additional financing will be available on terms advantageous to the existing terms or that additional financing will be available at all. Should the Company not be successful in obtaining the necessary financing to fund its operations, the Company would need to curtail certain or all of its operational activities, reduce costs or contemplate the sale of its assets if necessary.

**Results of Operations**

The following table sets forth the results of operations for the three and nine months ended September 30, 2014 and 2013:

|                                      | Three Months Ended September 30, |                 | Nine Months Ended September 30, |                 |
|--------------------------------------|----------------------------------|-----------------|---------------------------------|-----------------|
|                                      | 2014                             | 2013            | 2014                            | 2013            |
| Revenues                             |                                  |                 |                                 |                 |
| Commissions                          | \$ 1,182,564                     | \$ 1,057,800    | \$ 3,781,037                    | \$ 3,276,160    |
| Principal transactions               | (72,833 )                        | (96,157 )       | 693,722 )                       | (60,779 )       |
| Investment banking                   | 2,742,111                        | 484,650         | 7,508,092                       | 1,546,344       |
| Advisory and other                   | 607,950                          | 483,041         | 1,658,008                       | 1,629,559       |
| Total revenues                       | \$ 4,459,792                     | \$ 1,929,334    | \$ 13,640,859                   | \$ 6,391,284    |
| Operating expenses                   |                                  |                 |                                 |                 |
| Compensation and benefits            | \$ 4,121,905                     | \$ 1,531,207    | \$ 10,065,468                   | \$ 5,530,637    |
| Brokerage and clearing fees          | 69,590                           | 95,218          | 333,020                         | 297,994         |
| Professional services                | 108,011                          | 113,329         | 369,684                         | 260,583         |
| Occupancy and equipment              | 258,705                          | 358,058         | 853,125                         | 1,051,354       |
| Communications and technology        | 217,361                          | 194,667         | 603,281                         | 537,942         |
| Depreciation and amortization        | 43,839                           | 39,899          | 126,498                         | 46,900          |
| Travel and entertainment             | 63,558                           | 60,605          | 199,086                         | 166,241         |
| Legal services and settlement        | 10,418                           | 303,601         | 38,344                          | 369,645         |
| Cost of underwriting capital         | -                                | -               | -                               | 49,600          |
| Other                                | 252,705                          | 328,115         | 837,509                         | 895,618         |
| Total operating expenses             | 5,146,092                        | 3,024,699       | 13,426,015                      | 9,206,514       |
| Operating income/(loss)              | (686,300 )                       | (1,095,365 )    | 214,844                         | (2,815,230 )    |
| Interest expense                     | (99,486 )                        | (81,849 )       | (280,157 )                      | (247,328 )      |
| Amortization of debt discount        | (6,755 )                         | (35,370 )       | (33,046 )                       | (109,561 )      |
| Loss on debt modification            | (9,023 )                         | -               | (271,322 )                      | -               |
| Loss on early extinguishment of debt | -                                | -               | -                               | (293,347 )      |
| Net loss before income tax           | \$ (801,564 )                    | \$ (1,212,584 ) | \$ (369,681 )                   | \$ (3,465,466 ) |
| Income tax expense                   | -                                | (2,737 )        | -                               | (11,999 )       |
| Net loss                             | \$ (801,564 )                    | \$ (1,215,321 ) | \$ (369,681 )                   | \$ (3,477,465 ) |

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For the three and nine months ended September 30, 2014, total revenues increased \$2,531,000 and \$7,250,000 or 131% and 113% over the same periods in 2013. The increases were primarily attributable to higher investment banking revenues and principal transactions – (a) \$2,257,000 increase in investment banking revenues and \$23,000 increase in principal transactions and (b) \$5,962,000 increase in investment banking revenues and \$754,000 increase in principal transactions for the three and nine months ended September 30, 2014, respectively.



**Investment Banking Revenue**

The following table sets forth our revenue and transaction volumes from our investment banking activities for the three and nine months ended September 30, 2014 and 2013:

|                                     | Three Months Ended September 30, |              | Nine Months Ended September 30, |               |
|-------------------------------------|----------------------------------|--------------|---------------------------------|---------------|
|                                     | 2014                             | 2013         | 2014                            | 2013          |
| Revenue:                            |                                  |              |                                 |               |
| Capital raise                       | \$ 2,487,011                     | \$ 355,150   | \$ 6,994,096                    | \$ 1,315,116  |
| Financial advisory                  | 255,100                          | 129,500      | 513,996                         | 231,228       |
| Total investment banking revenue    | \$ 2,742,111                     | \$ 484,650   | \$ 7,508,092                    | \$ 1,546,344  |
| Transaction volumes:                |                                  |              |                                 |               |
| Public offerings:                   |                                  |              |                                 |               |
| Capital underwritten participations | \$ -                             | \$ -         | \$ -                            | \$ 93,500,000 |
| Number of transactions              | -                                | -            | -                               | 4             |
| Private placements:                 |                                  |              |                                 |               |
| Capital raise                       | \$ 58,448,426                    | \$ 2,384,120 | \$ 85,244,032                   | \$ 55,000,000 |
| Number of transactions              | 3                                | 2            | 10                              | 6             |
| Financial advisory:                 |                                  |              |                                 |               |
| Transaction amounts                 | \$ -                             | \$ -         | \$ -                            | \$ -          |
| Number of transactions              | -                                | 3            | -                               | 3             |

For the three and nine months ended September 30, 2014, investment banking revenues were \$2,742,000 and \$7,508,000 or 61% and 55% of total revenues, respectively, representing increases of \$2,257,000 and \$5,962,000 or 466% and 386% over the three and nine months ended September 30, 2013, respectively. The increases were due to more banking transactions being closed. Of the \$2,742,000 and \$7,508,000 investment banking revenues for the three and nine months ended September 30, 2014, \$2,633,000 and \$4,616,000, respectively, were generated by FEP.

During the three and nine months ended September 30, 2014, two and one investment banking clients accounted for more than 10% of our total revenues, respectively. During the three and nine months ended September 30, 2013, no investment banking client accounted for more than 10% of our total revenues.

**Commission and Principal Transaction Revenue**

Our broker-dealer activity includes the following:

*Commissions* – Commissions include revenue resulting from executing trades in exchange-listed securities, over-the-counter securities and other transactions as agent.

*Principal Transactions* – Principal transactions consist of a portion of dealer spreads attributed to our securities trading activities as principal in NASDAQ-listed and other securities, and include transactions derived from our activities as a market-maker. Additionally, principal transactions include gains and losses resulting from market price fluctuations that occur while holding positions in our securities trading inventory.

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

|  | Three Months Ended September 30, |              | Nine Months Ended September 30, |              |
|--|----------------------------------|--------------|---------------------------------|--------------|
|  | 2014                             | 2013         | 2014                            | 2013         |
| <b>Commissions:</b>  |                                  |              |                                 |              |
| Institutional equities   | \$ 1,182,564                     | \$ 1,057,800 | \$ 3,781,037                    | \$ 3,276,160 |
| Total commission revenue   | \$ 1,182,564                     | \$ 1,057,800 | \$ 3,781,037                    | \$ 3,276,160 |
| <b>Principal transactions:</b>   |                                  |              |                                 |              |
| Customer principal transactions, proprietary trading and market making | \$ 286,785                       | \$ (72,904)  | \$ 740,871                      | \$ 21,607    |
| Investment portfolio   | (359,618)                        | (23,253)     | (47,149)                        | (82,386)     |
| Total principal transaction revenue                                    | \$ (72,833)                      | \$ (96,157)  | \$ 693,722                      | \$ (60,779)  |
| <b>Transaction Volumes:</b>  |                                  |              |                                 |              |
| Number of shares traded  | 80,129,923                       | 57,653,829   | 299,079,703                     | 149,573,579  |

For the three and nine months ended September 30, 2014, commission revenues were \$1,183,000 and \$3,781,000 or 27% and 28% of total revenues, respectively, representing increases of \$125,000 and \$505,00 or 12% and 15% over the three and nine months ended September 30, 2013, respectively. The increases commission revenues were primarily due to favorable market condition during the three and nine months ended September 30, 2014.

Principal transaction revenue consists of four different activities – customer principal trades, market making, and realized and unrealized gains and losses in our investment portfolio. As a broker-dealer, we account for all of our marketable security positions on a trading basis and as a result, all security positions are marked to fair market values. Returns from market making activities tend to be more volatile than acting as agent or principal for customers.

For the three and nine months ended September 30, 2014, principal transaction were \$73,000 loss and \$694,000 gains, respectively, consisting of \$287,000 and \$741,000 gains from customer principal transactions, proprietary trading and market making, respectively, and \$360,000 and \$47,000 losses on our investment portfolio, respectively.

For the three months ended September 30, 2013, principal transaction losses were \$96,000, consisting of a \$73,000 loss from customer principal transactions, proprietary trading and market making and a \$23,000 loss on our investment portfolio. For the nine months ended September 30, 2013, principal transaction losses were \$61,000, consisting of a \$22,000 gain from customer principal transactions, proprietary trading and market making, partially offset by a \$83,000 loss on our investment portfolio.

During the three and nine months ended September 30, 2014, there was no brokerage customer who accounted for more than 10% of our total revenue. During the three and nine months ended September 30, 2013, one brokerage customer accounted for more than 10% of our total revenue (approximately \$217,000 and \$731,000 in the aggregate).

**Compensation and Benefit Expenses**

Compensation and benefit expenses represent the largest component of our operating expenses and includes incentive compensation paid to sales, trading, research and investment banking professionals, as well as discretionary bonuses, salaries and wages, and stock-based compensation. Incentive compensation varies primarily based on revenue production. Discretionary bonuses paid to investment bankers and research analysts vary with revenue production, but also include other qualitative factors and are determined by management. Salaries, payroll taxes and employee benefits vary based primarily on overall headcount.

The following table sets forth the major components of our compensation and benefits for the three and nine months ended September 30, 2014 and 2013:

|   | Three Months Ended September 30, |                     | Nine Months Ended September 30, |                     |   |
|---|----------------------------------|---------------------|---------------------------------|---------------------|---|
|   | 2014                             | 2013                | 2014                            | 2013                |   |
| Incentive compensation and discretionary bonuses                                      | \$ 3,147,859                     | \$ 954,005          | \$ 7,480,573                    | \$ 2,879,860        |   |
| Salaries and wages  | 551,379                          | 459,688             | 1,583,307                       | 1,585,941           |   |
| Stock-based compensation  | 258,360                          | (21,682 )           | 459,633                         | 548,198             |   |
| Payroll taxes, benefits and other   | 164,307                          | 139,196             | 541,955                         | 516,638             |   |
| <b>Total compensation and benefits</b>  | <b>\$ 4,121,905</b>              | <b>\$ 1,531,207</b> | <b>\$ 10,065,468</b>            | <b>\$ 5,530,637</b> |   |
| Cash compensation and benefits as a percentage of core business revenue               | 85                               | % 77                | % 74                            | % 77                | % |
| Cash compensation and benefits excluding FEP as a percentage of core business revenue | 40                               | % 61                | % 45                            | % 69                | % |

For the three and nine months ended September 30, 2014, total compensation and benefits were \$4,122,000 and \$10,065,000, respectively, representing increases of \$2,591,000 and \$4,535,000 or 169% and 82% as compared to the same periods in 2013.

Incentive compensation and discretionary bonuses increased \$2,194,000 and \$4,407,000 or 230% and 160% because of higher commissions and investment banking revenues. For the three months ended September 30, 2014, salaries and wages increased \$92,000 or 20% due to the hiring of administrative employees. For the nine months ended September 30, 2014, salaries and wages was flat primarily due to a number of producers switched to entirely

commissions based compensation.

For the three months ended September 30, 2014, stock-based compensation increased \$280,000 or 1292% because of an adjustment made in same period in 2013. For the nine months ended September 30, 2014, stock-based compensation decreased \$88,000 or 16% due to the fact that a large number of options were granted in May 2013 with immediate vesting.

Payroll taxes and benefits increased \$25,000 or 18% during the three months ended September 30, 2014 due to additional hires and remained flat during the nine months ended September 30, 2014 primarily due to the better rate of the medical plans and the change in personnel mix.

Of the total compensation and benefits for the three and nine months ended September 30, 2014 and 2013, \$2,047,000 and \$3,725,000, and \$312,000 and \$527,000 were for FEP personnel, respectively.

During the three and nine months ended September 30, 2014, one sales professional accounted for more than 10% of total revenue (approximately \$697,000 and \$2,365,000 in the aggregate) and no customer accounted for more than 10% of total revenue. During the three and nine months ended September 30, 2013, one and two sales professionals who each accounted for more than 10% of total revenue (approximately \$684,000 and \$2,426,000 in the aggregate), respectively, and one customer accounted for more than 10% of total revenue (approximately \$217,000 and \$731,000 in the aggregate).

### *Other Operating Expenses*

Brokerage and clearing fees include trade processing expenses paid to our clearing broker, and execution fees paid to floor brokers and electronic communication networks. MC is a fully-disclosed broker-dealer which contracts a third party clearing broker to perform all of the clearance functions. The clearing broker-dealer processes and settles all of MC's customer transactions and maintains the detailed customer records. These expenses are almost entirely variable, and are based on commission revenue and trade volume. For the three months ended September 30, 2014, brokerage and clearing fees decreased \$26,000 or 27% due to a one-time adjustment. For the nine months ended September 30, 2014, brokerage and clearing fees increased \$35,000 or 12% as a direct result of higher commission revenues and principal transactions.

Professional services expense includes audit, accounting fees and various consulting fees. For the three months ended September 30, 2014, professional services expense was relatively flat as compared to the same period in 2013. For the nine months ended September 30, 2014, professional services expense increased 109,000 or 42% as compared to the same period in 2013 due to the heavy use of technology consultants during the second and third quarters of 2014.

Occupancy and equipment include rents and related costs of our office premises, equipment, software and leasehold improvements. Occupancy expense is largely fixed in nature while equipment expense can vary somewhat in relation to our business operations. For the three and nine months ended September 30, 2014, occupancy and equipment expenses decreased \$99,000 and \$198,000 or 28% and 19%, respectively, as compared to the same periods in 2013 due to (a) the San Francisco office lease having lower rental rate effective January 1, 2014 and (b) more space in New York office was subleased.

Communications and technology expense includes market data and quote services, voice, data and internet service fees, and data processing costs. For the three months ended September 30, 2014, communications and technology expense increased \$23,000 or 12% as compared to the same period in 2013 due to newly hired traders and sales producers. For the nine months ended September 30, 2014, communications and technology expense increased 65,000 or 12% as compared to the same periods in 2013 due to a prior year rebate received in the first quarter of 2013, partly offset by the increase in expense due to new hires.

Depreciation and amortization relate to the depreciation of our fixed assets and amortization of leasehold improvements. Depreciation and amortization are mostly fixed in nature. For the three months ended September 30, 2014, depreciation and amortization expenses were flat as compared to the same periods in 2013 due to the fact that capital equipment leases were entered into during the 3<sup>rd</sup> quarter of 2013. For the nine months ended September 30, 2014, depreciation and amortization expenses increased \$80,000 or 170% as compared to the same periods in 2013 due to (a) minimal fixed asset additions and most of the depreciable asset base were fully depreciated in 2013, and (b) capital equipment leases were entered into during the 3<sup>rd</sup> quarter of 2013.

Travel and business development expenses include business development costs by our sales professionals, investment bankers and non-deal road show expenses. Non-deal road shows are meetings in which management teams of our corporate clients present directly to our institutional investors. For the three and nine months ended September 30, 2014, travel and business development expenses increased \$3,000 and \$33,000 or 5% and 20% as compared to the same periods in 2013 due to higher number of banking transactions being closed and marketing activities to promote the DCN.

Legal expenses relate to services required during the normal course of our business. For the three and nine months ended September 30, 2014, legal expenses decreased \$293,000 and \$331,000 or 97% and 90%, respectively, as compared to the same periods in 2013 due to a litigation settled in September 2013. Currently, there is no litigation against the Company.

Cost of underwriting capital represents borrowing cost of capital to supplement MC's net capital to enable it to underwrite banking deals. For the three and nine months ended September 30, 2014, no costs of underwriting capital were incurred due to the fact that the banking transactions closed did not require underwriting capital.

The following expenses are included in other operating expenses for the three and nine months ended September 30, 2014 and 2013:

|   | Three Months Ended September 30, |            | Nine Months Ended September 30, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2014                             | 2013       | 2014                            | 2013       |
| Insurance                                       | \$ 85,965                        | \$ 130,170 | \$ 243,235                      | \$ 387,070 |
| Regulatory & filing fees                        | 58,586                           | 35,527     | 182,833                         | 124,348    |
| Provision for uncollectible accounts receivable | 30,000                           | 106,525    | 209,750                         | 228,558    |
| Other   | 78,154                           | 55,893     | 201,691                         | 155,642    |
| Total other operating expenses                  | \$ 252,705                       | \$ 328,115 | \$ 837,509                      | \$ 895,618 |

Other operating expenses include insurance, regulatory & filing fees, provision for uncollectible accounts receivable, and other miscellaneous expenses.

For the three months ended September 30, 2014, other operating expenses decreased \$75,000 or 23% as compared to the same period in 2013 due to (a) increases of \$23,000 and \$22,000 in regulatory & filing fees and other miscellaneous expenses, respectively, (b) partially offset by decreases of \$44,000 in insurance and \$76,000 in provision for uncollectible accounts receivable, respectively. For the nine months ended September 30, 2014, other operating expenses decreased \$58,000 or 6% as compared to the same period in 2013 due to (a) increases of \$58,000 and \$46,000 in regulatory & filing fees and other miscellaneous expenses, respectively, (b) partially offset by decreases of \$144,000 in insurance and \$18,000 in provision for uncollectible accounts receivable, respectively.

### *Amortization of Debt Discounts*

We issued various debts with stocks or warrants, for which total proceeds were allocated to individual instruments based on the relative fair values of each instrument at the time of issuance. The value of the stocks or warrants was recorded as discount on the debt and amortized over the term of the respective debt using the effective interest method.

For the three and nine months ended September 30, 2014 and 2013, amortizations of debt discounts for the remaining debt and related warrants were \$7,000 and \$33,000, \$35,000 and \$109,000, respectively.



***Off-Balance Sheet Arrangements***

We were not a party to any off-balance sheet arrangements during the three and nine months ended September 30, 2014 and 2013. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities and structured finance entities.

***Commitments***

The following table summarizes our significant commitments as of September 30, 2014, consisting of future minimum lease payments under all non-cancelable operating leases and other non-cancelable commitments with initial or remaining terms in excess of one year.

|                   | Notes Payable | Office Leases | Operating Leases | Capital Leases | Total         |
|-------------------|---------------|---------------|------------------|----------------|---------------|
| 2014              | \$ 1,474,848  | \$333,600     | \$ 144,800       | \$32,472       | \$ 1,985,720  |
| 2015              | 1,265,029     | 1,343,760     | 288,500          | 129,885        | 3,027,174     |
| 2016              | 122,260       | 1,353,354     | 36,000           | 100,500        | 1,612,114     |
| 2017              | 482,560       | 1,421,854     | -                | 28,283         | 1,932,697     |
| 2018              | -             | 1,437,268     | -                | -              | 1,437,268     |
| Thereafter        | -             | 2,189,662     | -                | -              | 2,189,662     |
| Total Commitments | 3,344,697     | 8,079,498     | 469,300          | 291,140        | 12,184,635    |
| Interest          | (304,097 )    | -             | -                | (28,038 )      | (332,135 )    |
| Net Commitments   | \$ 3,040,600  | \$8,079,498   | \$ 469,300       | \$263,102      | \$ 11,852,500 |

## **Critical Accounting Policies and Estimates**

The condensed consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to the valuation of securities owned and deferred tax assets. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

### ***Securities Owned***

Corporate Equities – are comprised primarily of exchange-traded equity securities that the Company takes selective proprietary positions based on expectations of future market movements and conditions. They are generally valued based on quoted prices from the exchange. To the extent these securities are actively traded, valuation adjustments are not applied and they are categorized in Level 1 of the fair value hierarchy. Certain securities are traded infrequently and therefore do not have observable prices based on actively traded markets. These securities are classified as Level 3 securities, if pricing inputs or adjustments are both significant to the fair value measurement and unobservable. The Company determines the fair value of infrequently trading securities using the observed closing price at measurement date, discounted for the put option value calculated through the Black-Scholes model or similar valuation techniques.

Stock Warrants – represent warrants to purchase equity in a publicly traded company. Such positions are considered illiquid and do not have readily determinable fair values, and therefore require significant management judgment or estimation. For these securities, the Company uses the Black-Scholes valuation methodology or similar techniques. They are classified within Level 3 of the fair value hierarchy.

Underwriters' Purchase Options – represent the overallotment of units for a publicly traded company for which the Company acted as an underwriter. Such positions are considered illiquid and do not have readily determinable fair values, and therefore require significant management judgment or estimation. For these securities, the Company uses the Black-Scholes valuation methodology. They are classified within Level 3 of the fair value hierarchy.

### ***Valuation of Securities Owned***

Securities owned and securities sold, not yet purchased are reflected in the condensed consolidated statements of financial condition on a trade-date basis. Related unrealized gains or losses are generally recognized in principal transactions in the condensed consolidated statements of operations. The use of fair value to measure financial instruments is fundamental to our condensed consolidated financial statements and is one of our most critical accounting policies.

The fair value of a financial instrument is the amount 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 (the exit price). Instruments that we own (long positions) are marked to bid prices, and instruments that we have sold, but not yet purchased (short positions), are marked to offer prices. Fair value measurements are not adjusted for transaction costs. Fair values of our financial instruments are generally obtained from quoted market prices in active markets, broker or dealer price quotations, or alternative pricing sources with reasonable levels of price transparency. To the extent certain financial instruments trade infrequently or are non-marketable securities and, therefore, have little or no price transparency, we value these instruments based on management's estimates.

Substantially all of our financial instruments are recorded at fair value or contract amounts that approximate fair value. Securities owned and securities sold, not yet purchased, are stated at fair value, with any related changes in unrealized appreciation or depreciation reflected in principal transactions in the consolidated statements of operations. Financial instruments carried at contract amounts include cash and cash equivalents and amounts due from and to brokers, dealers and clearing brokers.

### *Stock-based Compensation Expense*

The Company measures and recognizes compensation expense based on estimated fair values for all stock-based awards made to employees and directors, including stock options, restricted stock and warrants. The Company estimates fair value of stock-based awards on the date of grant using the Black-Scholes option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense in the Company's consolidated statements of operations over the requisite service periods. Because stock-based compensation expense is based on awards that are ultimately expected to vest, stock-based compensation expense has been reduced to account for estimated forfeitures. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

To calculate stock-based compensation resulting from the issuance of options, and warrants, the Company uses the Black-Scholes option pricing model, which is affected by its stock price as well as assumptions regarding a number of subjective variables. These variables include, but are not limited to the Company's expected stock price volatility over the term of the awards, and actual and projected employee stock option exercise behaviors. No tax benefits were attributed to the stock-based compensation expense because a valuation allowance was maintained for all net deferred tax assets.

The Company accounts for equity-based compensation in accordance with the fair value provisions of ASC Topic 718. The Company used Income Approach to arrive at an estimated fair value of the Company's common stock to be used in the Black-Scholes option pricing model to determine the fair value of the option grants made during the three and nine months ended September 30, 2014.

The Company considered the following significant factors in preparing its fair value analyses:

- Observable inputs from the trading of its common stock on OTCQX;
- Guidelines Public Companies' Trading Multiples Method ("GPC");
- Back Solve approach.

To apply the Back Solve approach, the Company determined that it is appropriate to use the Option Pricing Method as the primary method for allocating the Company's equity value. The Company gave 50% weight each to the equity value arrived from the GPC and Back Solve approaches.

*Deferred Tax Valuation Allowance*

The Company accounts for income taxes in accordance with the provision of ASC 740, *Income Taxes*, which requires the recognition of deferred tax assets and liabilities at tax rates expected to be in effect when these balances reverse. Future tax benefits attributable to temporary differences are recognized to the extent that the realization of such benefits is more likely than not. The Company has concluded that it is not more likely than not that it will be able to realize the benefit of its deferred tax assets as of September 30, 2014 and December 31, 2013 based on the scheduling of deferred tax liabilities and projected taxable income. The amount of the deferred tax assets actually realized, however, could vary if there are differences in the timing or amount of future reversals of existing deferred tax liabilities or changes in the actual amounts of future taxable income. Should the Company determine that it will be able to realize all or part of the deferred tax asset in the future, an adjustment to the deferred tax asset will be recorded in the period such determination is made.

**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

Information concerning market risk is incorporated herein by reference to Item 7A of our Annual Report on Form 10-K and Form 10-K/A for the year ended December 31, 2013. There has been no material change in the quantitative and qualitative disclosure about market risk since December 31, 2013.

#### **ITEM 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

**Disclosure Controls and Procedures** – We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based upon our evaluation, our chief executive officer and principal financial officer concluded that our disclosure controls and procedures are effective, as of September 30, 2014, in ensuring that material information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms.

**Changes in Internal Control over Financial Reporting** – There were no changes in the Company’s internal control over financial reporting (as defined in Rules 13a-15(d) and 15d-15(d) of the Exchange Act) occurred during the three months ended September 30, 2014, that materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1.**

#### ***Legal Proceedings***

Certain conditions may exist as of the date the condensed consolidated financial statements are issued, which may result in a loss to the Company, but which will only be resolved when one or more future events occur or fail to occur. The Company assesses such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company, or unasserted claims that may result in such proceedings, the Company evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability and an estimate of the range of possible losses, if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed, unless they involve guarantees, in which case the guarantees would be disclosed. There can be no assurance that such matters will not materially and adversely affect the Company's business, financial position, and results of operations or cash flows.

From time to time, the Company is involved in ordinary routine litigation incidental to our business. Currently, there is no litigation against the Company.



**ITEM 1A. Risk Factors**

In addition to the information set forth in this report, including reports we incorporate by reference, you should carefully consider the risk factors previously disclosed in response to Item 1A to Part 1 of our Annual Report on Form 10-K for the year ended December 31, 2013, filed on March 31, 2014, as amended by our Form 10-K/A filed on April 30, 2014.

**ITEM 6. Exhibits**

31.1 Certification of Principal Executive Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Principal Financial Officer Pursuant To Section 302 of the Sarbanes-Oxley Act of 2002.

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

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**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.

**MERRIMAN HOLDINGS, INC.**

November 14, 2014 By: /s/ D. JONATHAN MERRIMAN  
D. Jonathan Merriman,  
Chief Executive Officer  
(Principal Executive Officer)

November 14, 2014 By: /s/ WILLIAM J. FEBBO  
William J. Febbo  
Principal Financial Officer  
(Principal Financial Officer)