

WEDBUSH MORGAN SECURITIES INC.

(SEC Identification No. 8-12987)

Statement of Financial Condition
(Unaudited)

September 30, 2009

The Company's audited statement of financial condition as of June 30, 2009, filed pursuant to S.E.C. Rule 17a-5, is available for examination at the Company's Los Angeles office and at the Los Angeles regional office of the Securities and Exchange Commission.

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Assets

Cash and cash equivalents	\$ 150,274,000
Cash segregated	141,956,000
Short-term investments segregated	1,313,000,000
Receivables:	
Brokers, dealers and clearing organizations	467,926,000
Customers, collateralized by securities	250,093,000
Other	<u>24,976,000</u>
Total receivables	742,995,000
Less allowance for doubtful receivables	<u>(6,980,000)</u>
Net receivables	736,015,000
Securities owned	48,072,000
Securities owned segregated	155,215,000
Intangibles	3,878,000
Other assets	<u>5,365,000</u>
	<u><u>\$ 2,553,775,000</u></u>

Liabilities and Stockholder's Equity

Bank loan payable	\$ —
Payables:	
Brokers, dealers and clearing organizations	382,197,000
Customers	1,854,984,000
Securities sold, not yet purchased	12,913,000
Accounts payable and accrued liabilities	<u>84,707,000</u>
Total liabilities	<u>2,334,801,000</u>
Commitments and contingent liabilities	
Stockholder's equity:	
Common stock, \$0.10 par value. Authorized 20,000,000 shares; 7,000,000 shares issued and outstanding	700,000
Additional paid-in capital	8,659,000
Parent treasury stock, 123,497 shares	(2,011,000)
Retained earnings	<u>211,626,000</u>
Total stockholder's equity	<u>218,974,000</u>
	<u><u>\$ 2,553,775,000</u></u>

See accompanying notes to Statement of Financial Condition.

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Notes to Statement of Financial Condition

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(1) Summary of Significant Accounting Policies

Wedbush Morgan Securities Inc. (Company) is an investment bank registered with the U.S. Securities and Exchange Commission as a securities broker dealer. The Company is wholly owned by WEDBUSH, Inc.

(a) Use of Estimates and Evaluation of Subsequent Events

In preparing the statement of financial condition, management is required to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the statement of financial condition. The most important of these estimates and assumptions relate to fair value measurements. Although these and other estimates and assumptions are based on the best available information, actual results could be materially different from these estimates.

Management has evaluated whether events or transactions which have occurred after September 30, 2009 require recognition or disclosure in the statement of financial condition. The evaluation was conducted through November 13, 2009, which is the date the statement of financial condition was available for issuance.

(b) Securities Transactions

The Company records its securities transactions on a trade date basis.

(c) Cash and Cash Equivalents

Cash and cash equivalents include investments in money market funds.

(d) Cash Segregated

Cash segregated represents deposits held in money market deposit accounts at banks segregated for the exclusive benefit of customers in compliance with regulatory requirements.

(e) Short-Term Investments Segregated

Short-term investments segregated consists of securities guaranteed by the U.S. government purchased under agreements to resell which are treated as financing transactions and are carried at the amounts at which the securities will subsequently be resold, as specified in the related agreements. It is the policy of the Company to obtain collateral with a fair value equal to or in excess of the principal amount loaned under resell agreements. These investments are held in segregated accounts for the exclusive benefit of customers.

(f) Customer Receivable/Payable and Reserve for Uncollectible Receivables

Amounts receivable from and payable to customers include amounts due or held on cash and margin transactions. Receivables from customers are generally fully secured by securities held in the customers' accounts. The value of securities owned by customers and held as collateral for the receivables is not reflected in the statement of financial condition.

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A reserve is established for amounts due from customers and others to the degree to which the receivable is unsecured. The Company also establishes a general reserve against accounts receivable for amounts that it determines in its best estimate may become uncollectible. Factors considered by management in determining the amount of the allowance include past experience, degree of concentration and quality of collateral.

(g) *Financial Instruments*

Substantially all of the Company's financial instruments, including securities owned, securities owned segregated and securities sold, not yet purchased, are carried at fair value. Assets, including securities borrowed or purchased under agreements to resell and certain receivables, are carried at fair value or contracted amounts that approximate fair value due to the short period to maturity. Similarly, liabilities, including securities loaned and certain other payables, are carried at amounts approximating fair value.

Effective July 1, 2008 the Company adopted Accounting Standards Codification (ASC) 820-10, *Fair Value Measurements and Disclosures* (ASC 820). Fair value is defined under ASC 820 as the price which would be received to sell an asset or would be paid to settle a liability (i.e. "the exit price") in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy that prioritizes inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to the use of observable inputs and lowest priority to the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are based on market pricing data obtained from sources independent of the Company. Unobservable inputs reflect the Company's judgment about the assumptions market participants would use in pricing the asset or liability. The three levels of the fair value hierarchy based on observability of inputs are as follows:

Level 1 – Valuations based on quoted prices available in active markets for identical assets or liabilities. This category includes U.S. Government and exchange-traded securities.

Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are considered observable, either directly or indirectly. This category includes U.S. agency, municipal, corporate debt and mortgage-backed securities.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement. This category includes private equity investments and limited partnerships.

(h) *Securities Owned Segregated*

Securities owned segregated include securities guaranteed by the U.S. government held in segregated accounts for the exclusive benefit of customers in compliance with regulatory requirements.

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(i) Intangibles

Intangibles consist of investment executive relationships and non-compete agreements which are amortized in full using the straight-line method over four years. The intangibles are subject to evaluations for impairment on an annual basis unless circumstances warrant a more frequent assessment.

(j) Income Taxes

Effective July 1, 2009 the Company accounts for tax uncertainties under the procedures established by ASC 740, *Income Taxes*.

The Company is included in the filing of a consolidated tax return for federal tax purposes and in combined returns for certain states where such filing is required or permitted. The Company is also a party to a tax allocation agreement with its parent, whereby its share of consolidated or combined tax liabilities is determined as if the Company had filed separate returns.

(k) Stock Based Compensation

The parent company has a stock option and awards plan, under which the Company is authorized to issue up to 1,392,000 shares and options to acquire shares of parent common stock. The plan's terms and conditions, including vesting, are determined by the parent's board of directors, and restrictions may be applied to awards under the plan. Options are issued at the fair value of the underlying parent common stock on the grant date, and generally become exercisable ratably over four years, and expire five years after the option becomes exercisable. Restricted awards in parent common stock are also granted and may vest over periods ranging up to four years. The parent company issues new shares upon the vesting of stock based awards and upon the exercise of stock options.

The Company recognized compensation expense of options granted based on estimate grant date fair value using the Black-Scholes option pricing model. The model takes into account the exercise price and expected life of the options, the current price of the underlying stock and its expected volatility, expended dividends and the risk free interest rate for the expected term of the option. Judgment is required in determining certain of the inputs to the model. The expected life option is based on an analysis of historical employee exercise behavior. The expected volatility is based on the parent company's historical monthly stock price volatility. The fair value of the option estimated at the date of grant is not adjusted for subsequent changes in the assumptions.

(l) Accounting Developments

The Financial Accounting Standards Board (FASB) issued several new Accounting Standards Updates (ASU), none of which are expected to have any material impact on the Company's financial statements.

In July 2009, the FASB established ASU 2009-1, *The FASB Accounting Standards Codification* (the Codification) as the single source for U.S. GAAP. While the Codification

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did not change U.S. GAAP, it introduced a new structure to the accounting literature and changed references to accounting standards and other authoritative accounting guidance. The Codification was effective as of July 1, 2009.

In August 2009, the FASB issued ASU 2009-5, *Fair Value Measurements and Disclosures – Measuring Liabilities at Fair Value* (ASU 2009-5). ASU 2009-5 provides additional guidance in measuring liabilities when a quoted price in an active market for an identical liability is not available. ASU 2009-5 is effective for the first reporting period after issuance, therefore, the Company will fully adopt the provisions of the guidance beginning October 1, 2009.

In September 2009, the FASB issue ASU 2009-6, *Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities* (ASU 2009-6). ASU 2009-6 provides additional guidance to accounting for uncertainty in income taxes and changed the disclosure requirements for nonpublic entities. The implementation guidance was not intended to change practice and did not change other income tax accounting guidance. The amendments provided clarification on the following: 1) what constitutes a tax position for a pass-through or not-for-profit entity; 2) determining when an income tax is attributed to the reporting entity or its owners; and 3) application of accounting for uncertainty in income taxes to a group of related entities composed of both taxable and nontaxable entities. ASU 2009-6 became effective for fiscal periods ending after September 15, 2009; therefore, the Company fully adopted the guidance for the quarter ending September 30, 2009.

In September 2009, the FASB issued ASU 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)* (ASU 2009-12). ASU 2009-12 provides additional guidance about measuring the fair value of certain alternative investments, such as hedge funds, private equity funds, real estate funds and venture capital funds. ASU 2009-12 allows companies to determine the fair value of such investments using net asset value as a practical expedient. ASU 2009-12 also requires new disclosures of the nature and risk of the investments by major category of alternative investments. The guidance is effective for fiscal periods beginning after December 15, 2009; therefore, the Company will fully adopt the provisions of the guidance beginning January 1, 2010.

In December 2007, the FASB amended ASC 805, *Business Combinations* (ASC 805). The amendments expanded the definition of transactions and events that qualify as business combinations; requires that the acquired assets and liabilities be recorded at the fair value determined on the acquisition date with changes thereafter reflected in revenue; and requires acquisition costs to be expensed as incurred. The amendments to ASC 805 are effective for any business combinations initiated by the Company after June 30, 2009.

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(2) Receivables from and Payables to Brokers, Dealers and Clearing Organizations

Amounts receivable from and payable to brokers, dealers and clearing organizations result from the Company's normal trading and securities borrowing and lending activities and consist of the following:

Securities failed to deliver	\$ 3,650,000
Deposits paid on securities borrowed	440,448,000
Amounts due from brokers and dealers through clearing organizations	12,743,000
Deposits with clearing organizations	11,085,000
Total receivables from brokers, dealers and clearing organizations	<u>\$ 467,926,000</u>
Securities failed to receive	\$ 3,945,000
Deposits received for securities loaned	377,205,000
Other	1,047,000
Total payables to brokers, dealers and clearing organizations	<u>\$ 382,197,000</u>

Deposits are paid for securities borrowed and are received for securities loaned based on the approximate fair value of the related securities. Fails to deliver and fails to receive represent the contractual value of securities that have not been delivered or received on or before the settlement date.

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(3) Financial Instruments

The following table presents the Company's financial instruments measured at fair value on a recurring basis as of September 30, 2009:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance at Fair Value
Assets:				
Short-term investments segregated				
Reverse repurchase agreements	—	1,313,000,000	—	1,313,000,000
Total short-term investments segregated	\$ —	1,313,000,000	—	1,313,000,000
Securities owned				
U.S. government securities	\$ 92,000	—	—	92,000
U.S. agency and municipal securities	—	24,399,000	—	24,399,000
Corporate debt securities	—	1,400,000	—	1,400,000
Corporate equities:				
Business services	2,991,000	—	—	2,991,000
Consumer products	6,413,000	—	—	6,413,000
Financials	3,150,000	—	—	3,150,000
Industrials	1,409,000	—	—	1,409,000
Life sciences	990,000	—	—	990,000
Technology	2,335,000	—	—	2,335,000
Other Industries	4,820,000	—	—	4,820,000
Listed options	73,000	—	—	73,000
Total securities owned	\$ 22,273,000	25,799,000	—	48,072,000
Securities owned segregated				
U.S. government securities	155,215,000	—	—	155,215,000
Total securities owned segregated	\$ 155,215,000	—	—	155,215,000
Liabilities:				
Securities sold, not yet purchased				
U.S. agency and municipal securities	\$ —	59,000	—	59,000
Corporate debt securities	—	5,665,000	—	5,665,000
Corporate equities:				
Business services	61,000	—	—	61,000
Consumer products	220,000	—	—	220,000
Financials	1,090,000	—	—	1,090,000
Industrials	85,000	—	—	85,000
Life sciences	38,000	—	—	38,000
Technology	996,000	—	—	996,000
Other Industries	4,699,000	—	—	4,699,000
Total securities sold, not yet purchased	\$ 7,189,000	5,724,000	—	12,913,000

The primary inputs in determining fair value are quotations for closing prices from national securities exchanges as well as reported bid and offer quotations from parties trading the security.

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During the quarter ended September 30, 2009 there were no changes to the valuation techniques employed by the Company in determining fair value.

(4) Intangibles

The following is a summary of intangibles as of September 30, 2009:

	<u>Amount</u>
Investment executive relationships	\$ 3,498,000
Non-compete agreements	1,394,000
Total intangibles	<u>4,892,000</u>
Less accumulated amortization	<u>(1,014,000)</u>
Net intangibles	<u>\$ 3,878,000</u>

Amortization on the intangibles to be recorded in subsequent periods is as follows:

Fiscal year ending:	
2010	\$ 675,000
2012	1,350,000
2013	1,350,000
2014	558,000
	<u>\$ 3,933,000</u>

On October 24, 2008, the Company acquired certain assets of Peacock, Hislop, Stanley & Givens including \$2,322,000 in tangible investment executive relationships with clients and non-compete agreements. In addition to the initial consideration, the asset acquisition agreement also provides for incremental consideration to be paid in the amount of \$150,000 per year over the next three years. The terms of the asset acquisition agreement also provide for contingent payments of up to approximately \$767,000 a year for the following three years if certain revenue thresholds are met and customer account levels maintained.

On December 31, 2008, the Company acquired certain assets of First Wall Street Corp. which included \$2,570,000 in intangible investment executive relationships with clients. The terms of the asset acquisition agreement provide for contingent payments of up to approximately \$250,000 in the year following the acquisition if certain revenue thresholds are met.

Any contingent payments will be additional purchase consideration and reflected in intangibles when such contingencies are resolved.

(5) Net Capital Requirement

The Company is subject to the Securities and Exchange Commission's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital. The Company has elected to use the alternative method permitted by the rule, which requires the maintenance of minimum net

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capital, as defined, equal to the greater of \$1,000,000 or 2% of aggregate debit balances arising from customer transactions, as defined.

The alternative method prohibits withdrawal of equity capital or payment of cash dividends if net capital does not exceed 5% of aggregate debit items and also prohibits withdrawal of subordinated capital if net capital does not exceed 4% of aggregate debit items. At September 30, 2009, the Company had net capital of \$176,273,000 that was 107% of aggregate debit items and \$172,968,000 in excess of the \$3,305,000 required minimum net capital at that date.

(6) Bank Credit Lines

The Company has the ability through arrangements with multiple banks to obtain secured and unsecured short-term borrowings primarily through the issuance of promissory notes. Under these agreements, the broker-dealer can borrow on demand up to a maximum of \$20,000,000 unsecured and \$70,000,000 secured at interest rates determined on the date of each borrowing, and reset daily. At September 30, 2009, there were no borrowings outstanding under these credit lines.

(7) Profit-Sharing Retirement Plans

At September 30, 2009, the Company had two trustee defined contribution retirement plans. The Commissioned Employees' PS Retirement Plan (the CPS Plan) is qualified under Section 401(k) of the Internal Revenue Code and covers eligible employees compensated on a commission and/or incentive basis. The Company's annual contributions are a specified percentage of the voluntary employee contributions and are not required if earnings do not exceed defined levels.

The Employees' PS Retirement Plan (the PS Plan) covers substantially all salaried employees. The Company's annual contributions under the Plan are determined by the board of directors, and are based on a percentage of employee compensation.

(8) Federal and State Income Taxes

Income taxes receivable of \$76,000 at September 30, 2009 is included in other assets on the statement of financial condition.

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The Company recognizes deferred tax assets and liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Temporary differences and carryforwards, which give rise to deferred tax assets and liabilities, consist of the following:

Deferred tax assets:	
Allowance for doubtful receivables	\$ 2,844,000
Legal reserves	2,611,000
Other	1,255,000
Total deferred tax assets	<u>6,710,000</u>
Less deferred tax liabilities:	
Unrealized gains not taxable	(1,566,000)
Allowance for expenses not yet incurred	(414,000)
Total deferred tax liabilities	<u>(1,980,000)</u>
Net deferred tax assets	<u>\$ 4,730,000</u>

Net deferred taxes assets are included in other assets on the statement of financial condition. The Company has reviewed all of its deferred tax assets to assess whether a valuation allowance should be established to the extent it is more likely than not that any portion of the deferred tax asset will not be realized.

(9) Stock Options and Awards

As of September 30, 2009, there were 123,497 options outstanding related to parent company stock, none of which were exercisable. The weighted average remaining life of the options until expiration was 6.3 years. As of September 30, 2009, there was \$463,837 in share-based compensation related to non-vested option and stock awards which will be recognized over a weighted average period of 1.2 years.

(10) Commitments and Contingent Liabilities

(a) Legal Matters

The Company is subject to ongoing litigation and claims in the normal course of its business. Management accrues for the settlement of such litigation and claims when a liability is deemed probable and estimable. In the opinion of management, the potential and threatened claims in which the Company is involved are not expected to have a material impact on the Company's financial position.

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(b) Lease Commitments

The Company's operations are conducted in leased premises under lease agreements requiring minimum annual payments as follows:

Fiscal year ending:	
2010	\$ 8,889,000
2011	5,920,000
2012	4,684,000
2013	3,908,000
2014	1,321,000
Thereafter	443,000
	<u>\$ 25,165,000</u>

Certain of these leases have escalation clauses and renewal options.

(11) Related-Party Transactions

In the normal course of business, employees, officers, directors and affiliates may buy and sell securities through the Company. At September 30, 2009, included in receivables from customers and payables to customers on the statement of financial condition, were receivables from officers and directors of \$9,331,000 and from affiliates of \$23,262,000, and payables to officers and directors of \$18,219,000 and to affiliates of \$4,390,000. Management believes receivables from officers, directors, and affiliates to be at market terms and rates of interest and are collateralized by securities. Net notes receivable from employees of \$10,809,000 and other receivables from affiliates of \$119,000 at September 30, 2009 are included in other receivables on the statement of financial condition. Notes receivable from employees are generally from recruiting activities, non-interest bearing, and forgiven over a period of three to eight years.

The Company markets and places certificates of deposit (CDs) from an affiliated bank (Wedbush Bank) with its customers. As of September 30, 2009, outstanding CD's under this program were \$51,502,000.