

Statement of Financial Condition

**WEBBUSH SECURITIES INC.**

(SEC Identification No. 8-12987)

September 30, 2011

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**WEDBUSH SECURITIES INC.**

Statement of Financial Condition

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<b>Assets</b>	
Cash and cash equivalents	\$ 40,069,000
Cash and securities segregated for regulatory purposes	1,766,397,000
Receivables:	
Brokers, dealers and clearing organizations	591,418,000
Clients, less reserves of \$6,418,000	355,736,000
Other	52,666,000
Securities borrowed	1,196,574,000
Securities purchased under agreements to resell	79,742,000
Securities owned, at fair value	92,959,000
Deferred tax assets	4,836,000
Other assets	3,058,000
	<hr/>
Total assets	\$ 4,183,455,000
<b>Liabilities and Stockholder's Equity</b>	
Bank loan payable	\$ -
Payables:	
Brokers, dealers and clearing organizations	9,443,000
Clients	2,497,750,000
Securities loaned	1,273,194,000
Securities sold, not yet purchased, at fair value	65,233,000
Accounts payable and accrued liabilities	89,214,000
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Total liabilities	3,934,834,000
Commitments and contingent liabilities	
Stockholder's equity:	
Common stock, \$0.10 stated value. Authorized 20,000,000 shares;	
7,000,000 shares issued and outstanding	700,000
Additional paid-in capital	9,503,000
Retained earnings	240,341,000
Parent treasury stock, 115,985 shares	(1,923,000)
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Total stockholder's equity	248,621,000
Total liabilities and stockholder's equity	\$ 4,183,455,000

See accompanying notes to financial condition.

## WEDBUSH SECURITIES INC.

### Notes to Statement of Financial Condition

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#### **(1) Summary of Significant Accounting Policies**

Wedbush Securities Inc. (the Company) is an investment bank registered with the U.S. Securities and Exchange Commission as a securities broker-dealer. Wedbush Securities Inc. changed its name from Wedbush Morgan Securities Inc. on February 16, 2010. The Company is wholly owned by WEDBUSH, Inc.

A summary of significant accounting policies is either discussed below or included in the following footnotes.

##### **(a) *Use of Estimates and Evaluation of Subsequent Events***

In preparing the financial statements, 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 financial statements and revenues and expenses during the reported period. 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.

##### **(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) *Securities Purchased Under Agreements to Resell***

Securities purchased under agreements to resell are collateralized financing transactions and are recorded at their contracted repurchase amounts, plus accrued interest. Contract values approximate fair market value. 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.

##### **(e) *Accounting Developments***

The following Accounting Standards Updates (ASU) are not expected to have any material impact on the Company's financial statements.

In April 2011, the FASB issued ASU 2011-03, *Transfers and Servicing (Topic 860)*. The update provides amended criterion for determining a company's effective control in regards to repurchase agreements. The amendments remove the assessment criterion where it must be evaluated if the transferor has the practical ability to perform in a repurchase agreement. This pronouncement does not have an effect on the Company's financial statements or repurchase agreement evaluation procedures. ASU 2011-03 is effective for periods beginning after December 15, 2011.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurements and Disclosures (Topic 820) — Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. ASU 2011-04 clarifies the application of existing fair value measurement and disclosure requirements, changes certain principles related to measuring fair value and requires additional disclosures about fair value measurements. ASU 2011-04 is effective for periods beginning after December 15, 2011.

## WEBBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

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The Company does not expect, upon adoption, that there will be any material impact on its financial statements.

In September 2011, the FASB issued ASU 2011-08, Intangibles— Goodwill and Other (Topic 350)— Testing Goodwill for Impairment, which simplifies how entities test goodwill for impairment by permitting an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the quantitative, two-step goodwill impairment test. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company will adopt these amended principles in conjunction with its impairment tests for the 2012 fiscal year. The pronouncement does not affect the Company's financial condition, results of operations or cash flows.

### **(2) Cash and Securities Segregated for Regulatory Purposes**

The Company segregates cash, short-term investments purchased under an agreement to resell and securities owned according to the regulatory standards of 15c3-3 of the Securities and Exchange Act of 1934. These assets are held in segregated accounts and are exclusively for the benefit of customers. Cash is held in money market deposit accounts at banks. Short-term investments are purchased under agreements to resell and are carried at the amounts at which the securities will subsequently be resold, as specified in the related agreements and consist of U.S. Treasuries and securities guaranteed by the U.S. government. Securities owned consist of securities guaranteed by the U.S. government.

Cash	\$ 111,287,000
Short-term investments purchased under agreements to resell	1,629,000,000
Securities owned	<u>26,110,000</u>
Total cash and securities segregated for regulatory purposes	<u><u>\$ 1,766,397,000</u></u>

### **(3) 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 activities and consist of the following:

Securities failed to deliver	\$ 21,508,000
Amounts due from brokers and dealers through clearing organizations	492,755,000
Deposits with clearing organizations	<u>77,155,000</u>
Total receivables from brokers, dealers and clearing organizations	<u><u>\$ 591,418,000</u></u>
Securities failed to receive	\$ 5,603,000
Other	<u>3,840,000</u>
Total payables to brokers, dealers and clearing organizations	<u><u>\$ 9,443,000</u></u>

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.

## WEBBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

September 30, 2011

#### **(4) Clients Receivable/Payable**

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

A reserve is established for amounts due from clients 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. Receivables are presented net of uncollectible reserves. The reserve as of September 30, 2011, was \$6,418,000.

#### **(5) Securities Borrowed and Loaned Transactions**

Securities borrowed and securities loaned transactions are recorded at the amount of cash collateral advanced or received. Collateral in the form of cash or securities is exchanged for securities borrowed and is received for securities loaned based on the approximate fair value of the related securities. The collateral is adjusted daily to reflect changes in the current market value of the underlying securities. Contract values approximate fair market value.

#### **(6) Financial Instruments**

The Company's financial instruments that are carried at fair value include securities owned, securities segregated and securities sold, not yet purchased.

##### **(a) Fair Value of Financial Instruments**

Fair value is defined under Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures* (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.

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.

Level 3 – Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

##### **(b) Valuation Technique**

Securities owned and securities sold, not yet purchased that are reported as Level 1 are based on quotations for closing prices from national securities exchanges as well as reported bid and offer quotations from

## WEBBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

September 30, 2011

parties trading the security. If quoted prices are not available, fair values are obtained from pricing services, broker quotes, or other model-based valuation techniques and reported as Level 2.

During the quarter ended September 30, 2011, there were no changes to the valuation techniques employed by the Company in determining fair value.

Transfers between fair value classifications occur when there are changes in pricing observability levels. There were no material transfers between level classifications during the quarter ended September 30, 2011.

**(c) Detail of Financial Instruments**

The following table presents financial instruments at fair value on a recurring basis as of September 30, 2011:

	<b>Active Markets for Identical Assets (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>Balance at Fair Value</b>
<b>Assets:</b>				
Trading securities				
U.S. government securities	\$ 130,000	\$ —	\$ —	\$ 130,000
U.S. agency and municipal securities	—	27,213,000	—	27,213,000
Corporate debt and mortgage-backed securities	—	13,161,000	—	13,161,000
Corporate equities:				
Business services	4,251,000	—	—	4,251,000
Consumer products	6,221,000	—	—	6,221,000
Financials	15,187,000	—	—	15,187,000
Industrials	1,465,000	—	—	1,465,000
Life sciences	478,000	—	—	478,000
Technology	2,509,000	—	—	2,509,000
Other industries	15,329,000	—	—	15,329,000
Listed options	<u>7,015,000</u>	<u>—</u>	<u>—</u>	<u>7,015,000</u>
Total trading securities	<u>52,585,000</u>	<u>40,374,000</u>	<u>—</u>	<u>92,959,000</u>
Securities segregated				
U.S. government securities	26,110,000	—	—	26,110,000
Securities segregated	<u>26,110,000</u>	<u>—</u>	<u>—</u>	<u>26,110,000</u>
<b>Liabilities:</b>				
Trading securities sold, not yet purchased				
U.S. government securities	\$ 677,000	\$ —	\$ —	\$ 677,000
U.S. agency and municipal securities	—	121,000	—	121,000
Corporate debt securities	—	138,000	—	138,000
Corporate equities:				
Business services	1,295,000	—	—	1,295,000
Consumer products	2,383,000	—	—	2,383,000
Financials	3,848,000	—	—	3,848,000
Industrials	829,000	—	—	829,000
Life sciences	115,000	—	—	115,000
Technology	7,388,000	—	—	7,388,000
Other industries	8,447,000	—	—	8,447,000
Listed options	<u>39,992,000</u>	<u>—</u>	<u>—</u>	<u>39,992,000</u>
Total trading securities sold, not yet purchased	<u>\$ 64,974,000</u>	<u>\$ 259,000</u>	<u>\$ —</u>	<u>\$ 65,233,000</u>

## WEBBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

September 30, 2011

Certain assets and liabilities including cash and cash equivalents, cash and securities segregated, client receivables and payables, securities borrowed and loaned, securities purchased under agreements to resell and accounts payable, receivables and payables from and to other brokers, dealers and clearing organizations have a carrying value that approximates fair market value as of September 30, 2011

**(d) *Risks Related to Financial Instruments***

In the normal course of business, the Company is involved in the execution, settlement and financing of various client and principal securities transactions. Client activities are transacted on a cash, margin or delivery-versus-payment basis. Securities transactions are subject to the risk of counterparty or client non-performance. However, transactions are collateralized by the underlying security, thereby reducing the associated risk to changes in the fair value of the security through settlement date or to the extent of margin balances.

The Company also has contractual commitments arising in the ordinary course of business for securities loaned, securities sold, not yet purchased, repurchase agreements, securities transactions on a when-issued basis and underwritings. Each of these financial instruments contains varying degrees of risk whereby the fair values of the securities underlying the financial instruments may be in excess of the contract amount. The settlement of these transactions is not expected to have a material effect upon the Company's financial condition.

**(7) *Derivatives***

The Company invests in box-spread option positions as a source of cash financing. As of September 30, 2011, there were option positions with a December 2011 expiration date that have a cash settlement liability of \$40,000,000 and a fair value of \$39,958,000. The Company does not use derivatives for speculative purposes.

**(8) *Intangibles***

Intangible assets, which are included as a component of other assets on the Statement of Financial Condition, consist of investment executive relationships and non-compete agreements which are amortized on a straight-line basis over four years. The intangibles are subject to evaluations for impairment on an annual basis unless circumstances warrant a more frequent assessment. There is no impairment recorded during the quarter ended September 30, 2011.

The following is a summary of intangibles as of September 30, 2011:

Investment executive relationships	\$ 3,498,000
Non-compete agreements	<u>2,469,000</u>
Total intangibles	5,967,000
Less accumulated amortization	<u>(4,244,000)</u>
Net intangibles	<u><u>\$ 1,723,000</u></u>

On October 24, 2008, the Company acquired certain assets of a broker-dealer including \$2,322,000 of intangible 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

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thresholds are met and client account levels maintained. During the quarter ended September 30, 2011, there was \$373,000 of intangibles amortization and there were no contingent payments awarded based on the terms of the asset acquisition agreement. Contingent payments are additional purchase consideration and reflected in intangibles when such contingencies are achieved.

#### **(9) Stock Based Compensation – Options and Awards**

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.

As of September 30, 2011, there were 200,593 options and 10,454 restricted stock awards outstanding related to parent company stock. The weighted average remaining life of the options until expiration was 4.6 years.

#### **(10) 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 WEDBUSH, Inc., whereby its share of consolidated or combined tax liabilities is determined as if the Company had filed separate returns.

The Company assesses its tax positions for all open tax years and determines whether there are any material unrecognized liabilities in accordance with applicable accounting guidelines on accounting for uncertain income taxes. Liabilities are recorded to the extent they are deemed incurred. Interest and penalties, as applicable and related to uncertain tax positions, are recorded in income tax expense

##### **(a) *Federal and State Income Taxes***

For the federal and most state jurisdictions, the earliest tax period that remains subject to examination is the year ended June 30, 2007.

Income taxes receivable of \$4,102,000 at June 30, 2011, is included in other receivables on the Statement of Financial Condition.

##### **(b) *Deferred Tax Assets and Liabilities***

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:

## WEDBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

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#### Deferred tax assets:

Allowance for doubtful receivables	\$ 2,615,000
Legal reserves	2,673,000
Other	<u>3,071,000</u>
Total deferred tax assets	<u>8,359,000</u>

#### Less deferred tax liabilities:

Unrealized gains not taxable	(3,304,000)
Allowance for expenses not yet incurred	<u>(219,000)</u>
Total deferred tax liabilities	<u>(3,523,000)</u>
Net deferred tax assets	<u>\$ 4,836,000</u>

The Company has reviewed all of its deferred tax assets to assess whether a valuation allowance should be established for those tax assets. The firm recognizes tax positions in the financial statement only when it is more likely than not that the position will be sustained upon examination by the relevant taxing authority based on the technical merits of the position. The Company's management believes that it is more likely than not the deferred tax assets will be realized.

#### **(11) 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 capital, as defined, equal to the greater of \$1,000,000 or 2% of aggregate debit balances arising from client 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, 2011, the Company had net capital of \$151,090,000 that was 38% of aggregate debit items and \$143,082,000 in excess of the \$8,008,000 required minimum net capital at that date.

#### **(12) 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 Company can borrow on demand up to a maximum of \$20,000,000 unsecured and \$200,000,000 secured at interest rates determined on the date of each borrowing, and reset daily. At September 30, 2011, there were no borrowings outstanding under these credit lines.

#### **(13) Profit-Sharing Retirement Plans**

At September 30, 2011, the Company had two trustee-directed defined contribution retirement plans. The Commissioned Employees' PS Retirement Plan is qualified under Section 401(k) of the Internal Revenue Code and covers eligible colleagues compensated on a transaction fees and/or incentive basis. The Company's annual contributions are a specified percentage of the voluntary colleague contributions and are not required if earnings do not exceed defined levels.

## WEDBUSH SECURITIES INC.

### Notes to Statement of Financial Condition - Continued

September 30, 2011

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

#### **(14) Commitments and Contingent Liabilities**

##### **(a) Legal and Regulatory Matters**

The Company is subject to ongoing litigation and regulatory matters in the normal course of its business. Management accrues for the settlement when a liability is deemed probable and estimable. Costs incurred in responding to potential litigation and regulatory actions are expensed when incurred. In the opinion of management, the potential legal and regulatory matters in which the Company is involved are not expected to have a material impact on the Company's financial position or results of operations.

##### **(b) Lease Commitments**

The Company has contractual obligations under long-term non-cancelable lease agreements, principally for office space, requiring minimum annual payments as follows:

Fiscal year ending:		
2012	\$	7,477,000
2013		6,992,000
2014		4,259,000
2015		2,917,000
2016		2,207,000
Thereafter		<u>15,237,000</u>
	\$	<u>39,089,000</u>

Some of these leases have escalation clauses and renewal options.

#### **(15) Related-Party Transactions**

In the normal course of business, colleagues, officers, directors and affiliates may buy and sell securities through the Company. At September 30, 2011, included in receivables from clients and payables to clients on the Statement of Financial Condition were receivables from officers and directors of \$11,507,000 and from affiliates of \$4,293,000, and payables to officers and directors of \$25,520,000 and to affiliates of \$5,634,000. Management believes receivables from officers, directors and affiliates to be at market terms and rates of interest, and they are collateralized by securities. During the quarter ended September 30, 2011, the Company earned interest income from officers and directors of \$106,000 and from affiliates of \$227,000, and paid interest expense to officers and directors of \$3,000 and to affiliates of \$5,000.

Notes receivable from colleagues are generally from recruiting activities, non-interest bearing and forgiven over a period of three to eight years. Notes receivable from colleagues of \$9,531,000 and other receivables from affiliates of \$22,790,000 at September 30, 2011, are included in other receivables on the Statement of Financial Condition.

On June 10, 2011, the parent company acquired Lime Brokerage LLC ("Lime"), a provider of trading technologies and agency brokerage services. As of September 30, 2011, Lime had a clearing deposit of \$250,000 and a receivable balance of \$453,000 with the Company.