Merriman Holdings, Inc
Form 10-Q
November 14, 2012

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

¨ 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	11-2936371
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

600 California Street, 9th Floor
San Francisco, CA 94108
(Address of Principal Executive Offices) (Zip Code)

(415) 248-5600

(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 x 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 x

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 x

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

The number of shares of Registrant's common stock outstanding as of November 8, 2012 was 4,346,770.

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		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenues				
Commissions	$1,716,268	$3,834,121	$4,615,763	$10,821,486
Principal transactions	(294,326)	(910,382)	(277,428)	(417,399)
Investment banking	468,010	900,879	4,690,879	8,051,512
Advisory and other	569,555	261,920	1,415,138	557,759
Total revenues	2,459,507	4,086,538	10,444,352	19,013,358
Operating expenses				
Compensation and benefits	2,108,096	3,169,959	7,612,279	14,554,357
Stock-based compensation	171,604	59,646	2,048,313	598,151
Brokerage and clearing fees	158,199	326,236	438,782	1,087,182
Professional services	80,726	363,816	535,112	1,127,193
Occupancy and equipment	420,746	483,834	1,307,823	1,407,554
Communications and technology	240,808	491,197	815,202	1,499,666
Depreciation and amortization	5,590	20,755	16,530	117,160
Travel and entertainment	104,304	200,411	306,556	747,028
Legal services and litigation settlement expense	159,544	104,322	495,329	549,681
Cost of underwriting capital	-	-	152,600	97,625
Other	9,971	549,988	901,475	1,346,051
Total operating expenses	3,459,588	5,770,164	14,630,001	23,131,648
Operating loss	(1,000,081)	(1,683,626)	(4,185,649)	(4,118,290)

Other income	-	15,000	15,000	26,601
Interest income	-	-	1,763	3,938
Interest expense	(64,513)	(121,574)	(179,116)	(286,364)
Amortization of debt discount	(30,290)	(49,563)	(87,027)	(45,122)
Loss on equity exchange	-	-	(1,086,329)	-
Net loss before income taxes	(1,094,884)	(1,839,763)	(5,521,358)	(4,419,237)
Income tax benefit (expense)	-	(2,763)	-	(6,107)
Net loss	$(1,094,884)	$(1,842,526)	$(5,521,358)	$(4,425,344)
Preferred stock cash dividend	-	(129,433)	-	(407,212)
Net loss attributable to common shareholders	$(1,094,884)	$(1,971,959)	$(5,521,358)	$(4,832,556)
Basic and diluted net loss per share				
Net loss	$(0.25)	$(0.69)	$(1.01)	$(1.78)
Net loss attributable to common shareholders	$(0.25)	$(0.74)	$(1.01)	$(1.94)
Weighted average number of common shares Basic and diluted	4,307,809	2,652,285	5,459,375	2,485,935

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, 2012	December 31, 2011
ASSETS		
Cash and cash equivalents	$1,702,733	$4,003,512
Securities owned		
Marketable, at fair value	843,744	2,136,352
Not readily marketable, at estimated fair value	652,617	347,218
Restricted cash	680,028	680,028
Due from clearing broker	49,050	124,805
Accounts receivable, net	369,620	359,900
Prepaid expenses and other assets	487,449	506,708
Equipment and fixtures, net	21,904	30,537
Total assets	$4,807,145	$8,189,060
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities		
Accounts payable	$332,359	$246,040
Commissions and bonus payable	436,653	986,722
Accrued expenses and other	546,427	1,757,342
Deferred rent	372,917	236,996
Deferred revenue	175,830	688,074
Notes payable, net of debt discount	892,591	679,454
Notes payable to related parties, net of debt discount	1,352,863	1,006,765
Total liabilities	4,109,640	5,601,393
Shareholders' equity		
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, 2012 and December 31, 2011; 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, 2012 and December 31, 2011; 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, 2012 and December 31, 2011; aggregate liquidation preference of $0	-	-
Convertible preferred stock, Series D–$0.0001 par value; 24,000,000 shares authorized, 23,720,916 and 23,720,916 shares issued and 18,632,974 and	1,864	1,957

19,563,206 shares outstanding as of September 30, 2012 and December 31, 2011, respectively; aggregate liquidation preference of $8,372,727 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 and 2,531,744 shares issued and 6,825,433 and 2,531,744 shares outstanding as of September 30, 2012 and December 31, 2011, respectively; aggregate liquidation preference of $4,418,735 prior to conversion, and pari passu with common stock on conversion	682	253
Common stock, $0.0001 par value; 300,000,000 shares authorized; 4,346,770 and 6,183,815 shares issued and 4,317,334 and 6,154,379 shares outstanding as of September 30, 2012 and December 31, 2011, respectively	435	619
Additional paid-in capital	144,488,999	140,857,954
Treasury stock	(225,613)	(225,613)
Accumulated deficit	(143,568,862)	(138,047,503)
Total shareholders' equity	697,505	2,587,667
Total liabilities and shareholders' equity	$4,807,145	$8,189,060

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, 2012

(unaudited)

	Convertible Preferred Stock		Common Stock		Treasury Stock		Additional Paid-in	Accumulated	
	Shares	Amount	Shares	Amount	Shares	Amount	Capital	Deficit	Total
Balance at January 1, 2012	22,094,950	$2,210	6,183,815	$619	(29,436)	$(225,613)	$140,857,955	$(138,047,504)	$2,587,66
Net loss	-	-	-	-	-	-	-	(5,521,358)	(5,521,3
Conversion of Series D convertible preferred stock to common stock	(930,232)	(93)	317,460	32	-	-	61	-	-
Issuance of Series E convertible preferred stock	729,483	73	-	-	-	-	459,503	-	459,576
Issuance of restricted common stock	-	-	852,259	85	-	-	461,659	-	461,744
Issuance of warrants in connection with debt	-	-	-	-	-	-	77,792	-	77,792
Option forfeiture	-	-	-	-	-	-	1,074,943	-	1,074,94
Equity exchange	3,564,206	356	(3,006,764)	(301)	-	-	1,086,274	-	1,086,32
Preferred stock dividend	-	-	-	-	-	-	(42,061)	-	(42,061
Stock-based compensation	-	-	-	-	-	-	512,873	-	512,873

Balance at September 30, 2012	25,458,407	$2,546	4,346,770	$435	(29,436)	$(225,613)	$144,488,999	$(143,568,862)	$697,505

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

MERRIMAN HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

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

	Nine Months Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net loss	$ (5,521,358)	$ (4,425,344)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	16,530	117,160
Stock-based compensation	2,049,560	598,151
Loss on sale of accounts receivable	7,000	-
Loss on disposal of equipment and fixtures	-	13,359
Loss on equity exchange	1,086,329	-
Amortization of debt issuance costs	87,027	45,122
Provision for uncollectible accounts receivable	245,275	65,024
Securities received for services	(290,767)	(291,345)
Unrealized loss on securities owned	564,291	1,789,778
Changes in operating assets and liabilities:		
Securities owned	713,684	359,282
Restricted cash	-	284,972
Due from clearing broker	75,756	(159,099)
Accounts receivable	(120,510)	1,133,886
Prepaid expenses and other assets	(447,227)	(361,968)
Accounts payable	86,318	(150,652)
Commissions and bonus payable	(652,116)	(2,106,137)
Accrued expenses and other	(1,485,189)	(479,678)
Net cash used in operating activities	(3,585,397)	(3,567,489)
Cash flows from investing activities:		
Sale of note receivable	125,000	-
Sale of accounts receivable	500,000	-
Purchase of equipment and fixtures	(7,897)	(42,916)
Proceeds from sale of equipment and fixtures	-	10,000
Net cash provided by (used in) investing activities	617,103	(32,916)
Cash flows from financing activities:		

Issuance of note receivable	(125,000)	-
Proceeds from issuance of debt	375,000	3,100,000
Proceeds from issuance of temporary subordinated debt	4,100,000	2,800,000
Repayment of temporary subordinated debt	(4,100,000)	(3,130,000)
Proceeds from issuance of preferred stock	459,576	-
Payment of preferred stock dividend	(42,061)	(412,576)
Debt service principal payments	-	(120,453)
Net cash provided by financing activities	667,515	2,236,971
Decrease in cash and cash equivalents	(2,300,779)	(1,363,434)
Cash and cash equivalents at beginning of the period	4,003,512	4,898,093
Cash and cash equivalents at end of the period	$ 1,702,733	$ 3,534,659
Supplementary disclosure of cash flow information:		
Cash paid during the year:		
Interest and cost of underwriting capital	$ 268,852	$ 266,235
Income taxes	$ -	$ 10,290
Non-cash investing and financing activities:		
Warrants issued in connection with debt	$ 77,792	$ 419,637
Cancellation of stock issued in connection with debt	$ -	$ 105,759

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Significant Accounting Policies

Basis of Presentation

Merriman Holdings, Inc. (the Company) is a financial services holding company that provides investment banking, capital markets services, corporate services, and investment banking through its wholly-owned operating subsidiary, Merriman Capital, Inc. (MC). 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.

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 2011 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, 2011.

Under Accounting Standards Codification (ASC) Topic 855 – *Subsequent Events,* the Company has evaluated all subsequent events through the date these consolidated financial statements were issued. (See Note 12)

Going Concern/Liquidity

As of September 30, 2012, liquid assets consisted primarily of cash and cash equivalents of approximately $1,703,000 and marketable securities of approximately $844,000, totaling approximately $2,547,000. For the nine months ended September 30, 2012, the Company had negative cash flows from operations of approximately $3,585,000. The Company incurred substantial loss during the first nine months of 2012, having a net loss of approximately $5,521,000. As of September 30, 2012, the Company had an accumulated deficit of approximately $143,569,000. These facts raise substantial doubt as to our ability to continue as a going concern.

Accordingly, the accompanying unaudited 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.

During the third quarter of 2011, the Company began the process of eliminating non-profitable revenue activities and certain discretionary spending. The Company significantly reduced its operating expenses by eliminating certain non-revenue generating personnel, administrative positions and technology related costs. Prior to the cost cutting measures, we had 61 and employees and as of September 30, 2012, the Company had 29 full time employees. Additionally, in the fourth quarter of 2011, the Company shifted its strategic focus away from the traditional broker dealer model of research and institutional sales toward a capital markets advisory and platform revenue model. This represents a more scalable, predictable and profitable model in today's environment. Management believes this business model will result in reduced fixed operating costs and higher operating profit margin.

For the nine months ended September 30, 2012 and on December 30, 2011, the Company issued 729,483 and 2,531,744 shares of Series E Convertible Preferred Stock for proceeds of $459,576 and $1,595,000, respectively.

Management's plan to alleviate the going concern uncertainty includes, but is not limited to, the issuance of equity and debt instruments for working capital. The Company's continued existence is also dependent upon its ability to increase revenues generated from operations which will enable the Company to achieve a profitable level of operations.

While the Company believes its current funds and cash generated from operations will be sufficient to enable it to meet its planned expenditures through at least March 31, 2013, if anticipated operating results are not achieved, management has the intent and believes it has the ability to delay or reduce expenditures and or raise funds. In such case, the further reduction in operating expenses might need to be substantial in order for the Company to generate positive cash flow to sustain the operations of the Company. 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 or 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 and/or contemplate the sale of its assets if necessary.

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MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. Significant Accounting Policies – continued

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.

Reclassifications

Certain reclassifications have been made to the prior year's condensed consolidated financial statements to conform to the presentation of the current year's condensed consolidated financial statements. There were no changes to prior year's reported earnings.

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, securities owned, restricted cash, due from clearing broker, accounts receivable, accounts payable, commissions and bonus payable, accrued expenses and other, approximate their fair values.

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 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 stock-based compensation expense because a valuation allowance was maintained for all net deferred tax assets.

Adoption of New Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, that requires a company to present components of net income and other comprehensive income in one continuous statement or in two separate, but consecutive statements. There are no changes to the components that are recognized in net income or other comprehensive income under current GAAP. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011, with early adoption permitted. The Company adopted ASU No. 2011-05 effective January 1, 2012. The adoption did not have an impact on the Company's results of operations or financial position as there were no components of other comprehensive income for the periods presented.

In May 2011, the FASB issued ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. The amendments in this ASU generally represent clarification of Topic 820, but also include instances where a particular principle or requirement for measuring fair value or disclosing information about fair value measurements has changed. This update results in common principles and requirements for measuring fair value and for disclosing information about fair value measurements in accordance with GAAP and International Financial Reporting Standards ("IFRS"). The amendments are effective for interim and annual periods beginning after December 15, 2011 and are to be applied prospectively. The Company adopted ASU No. 2011-05 effective January 1, 2012. The adoption did not have an impact on the Company's results of operations or financial position, but did impact the Company's disclosures regarding fair value measurement.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

2. 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.

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 is 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 observed closing stock price at the measurement date. As of September 30, 2012, the fair value of this type of securities included in securities owned in the statements of financial condition is approximately $677,000.

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, 2012, the fair value of this type of securities included in securities owned in the statements of financial condition is approximately $254,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

2. Fair Value of Assets and Liabilities – continued

Stock Warrants

Also as partial compensation for investment banking services, the Company may receive stock warrants issued by the client. Stock warrants provide their holders with the right to purchase equity in a company. 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, 2012, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately $551,000.

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, 2012, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition is approximately $13,000.

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, 2012, the fair value of this type of securities included in securities owned in the condensed consolidated statement of financial condition was deemed de minimis.

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.

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MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

2. Fair Value of Assets and Liabilities — continued

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:				
Corporate equities	Put option discount using Black-Scholes option pricing model	Stock volatility	150 %	150 %
Stock warrants	Black-Scholes option pricing model	Stock volatility	22 - 296%	137 %
Underwriters' purchase options	Black-Scholes option pricing model	Stock volatility	156 %	156 %
Preferred stock	Exchange-quoted price of common stock equivalents	Preferred stock to common stock conversion rate	1.6	1.6

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

	Assets at Fair Value at September 30, 2012			
	Level 1	Level 2	Level 3	Total
Assets:				
Corporate equities	$ 677,143	$ -	$ 254,437	$ 931,580
Stock warrants	-	-	551,416	551,416
Underwriters' purchase option	-	-	13,302	13,302
Preferred stock	-	-	63	63
Total securities owned	$ 677,143	$ -	$ 819,218	$ 1,496,361

Liabilities:				
Securities sold, not yet purchased	$ 2,871	$ -	$ -	$ 2,871
Total fair value liabilities	$ 2,871	$ -	$ -	$ 2,871

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

2. Fair Value of Assets and Liabilities — continued

The following summarizes the change in carrying values associated with Level 3 financial instruments for the nine months ended September 30, 2012:

	Corporate Equities	Stock Warrants	Underwriters' Purchase Options	Preferred Stock	Total
Balance at December 31, 2011	$907,495	$683,211	$ 5,972	$ 395	$1,597,073
Purchases or receipt (a)	22,066	288,153	-	-	310,219
Sales or exercises	(801,997)	(328)	-	(83)	(802,408)
Gains (losses):					
Realized	290,393	-	-	-	290,393
Unrealized	(163,520)	(419,620)	7,330	(249)	(576,059)
Balance at September 30, 2012	$254,437	$551,416	$ 13,302	$ 63	$819,218
Change in unrealized gains (losses) relating to instruments still held at September 30, 2012	$17,480	$(419,620)	$ 7,330	$ (249)	$(395,059)

(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, as defined by ASC 820. 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. There were no significant transfers between our Level 1 and Level 2 classified instruments during the nine months ended September 30, 2012.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

3. Issuance of Debt

Notes Payable comprise of the following:

		Notes Payable	Notes Payable Related Party	Total
(a)	Subordinated notes payable	$ 50,000	$ 950,000	$1,000,000
	Debt discount	$ (3,697)	$ (70,236)	$(73,933)
		$ 46,303	$ 879,764	$926,067
(c)	Secured promissory notes	$ 920,000	$ 550,000	$1,470,000
	Debt discount	$ (73,712)	$ (76,901)	$(150,613)
		$ 846,288	$ 473,099	$1,319,387
	Total	$ 892,591	$ 1,352,863	$2,245,454

a. ***Subordinated Notes Payable***

On September 29, 2010, the Company borrowed $1,000,000 from nine individual lenders, all of whom were directors, officers or employees of the Company at the time of issuance, pursuant to a series of unsecured promissory notes (Subordinated Notes). The Subordinated Notes are for a term of three years and provide for interest comprising two components: (i) six percent (6.0%) per annum to be paid in cash monthly; and (ii) eight percent (8.0%) per annum to be accrued and paid in cash upon maturity. Additional consideration was paid to the lenders at closing comprising a number of shares of common stock of the Company equal to: (A) 30% of the principal amount lent; divided by (B) $3.01 per share. The total effective interest on the note is approximately 21.73%. Proceeds were used to supplement underwriting capacity and working capital for MC.

The total proceeds of $1,000,000 raised in the transaction above were accounted for as an issuance of debt with stock and have been allocated to the individual instruments based on the relative fair values of each instrument. Based on such allocation method, the value of the stocks issued in connection with the Subordinated Notes was $206,000, which was recorded as a discount on the debt and applied against the Subordinated Notes.

As of September 30, 2012, $880,000 of the Subordinated Notes, net of approximately $70,000 discount, remain outstanding and is included in notes payable to related parties in the Company's consolidated statements of financial condition. The remaining Subordinated Notes held by parties no longer related to the Company of $46,000, net of approximately $4,000 discount, are included in notes payable in the Company's condensed consolidated statements of financial condition.

The discount on the note is amortized over the term of the loan using the effective interest method. For the three and nine months ended September 30, 2012, the Company incurred approximately $36,000 and $104,000 in interest on the Subordinated Notes, respectively. As of September 30, 2012, total interest in the amount of approximately $168,000 remains outstanding and is 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)

3. Issuance of Debt — continued

b. ***Unsecured Promissory Notes***

On November 1, 2010, the Company issued $300,000 in unsecured promissory notes (Unsecured Promissory Notes) to four of its Series D Convertible Preferred Stockholders with a maturity date of the earlier of January 31, 2011 or the consummation of a qualified financing, as defined. The Unsecured Promissory Notes provide for interest of twelve percent (12%) per annum to be paid in cash at maturity. Additional consideration was paid to the lenders at closing comprising a number of shares of common stock of the Company equal to 55% of the principal amount lent divided by $3.01 per share.

The total proceeds of $300,000 raised in the transaction above is accounted for as an issuance of debt with stock and have been allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on such allocation method, the value of the stock issued in connection with the Unsecured Promissory Notes was $106,000, which was recorded as a discount on the debt and applied against the Unsecured Promissory Notes.

On January 31, 2011, the Company amended its Unsecured Promissory Notes to extend their maturity dates from January 31, 2011 to December 31, 2011. The interest rate from the amendment date to the maturity date was increased to 13%. Furthermore, the additional common stock consideration was cancelled and returned to the Company; as such $65,000 of previously amortized discount on debt was reversed.

On December 14, 2011, the Company entered into exchange agreements with the Unsecured Promissory Note holders whereby the Note holders agreed to exchange the Unsecured Promissory Notes and Warrants for common shares and new warrants to purchase common shares of the Company as follows:

(a) For the Unsecured Promissory Notes, a number of new shares of common stock equal to (i) the total amount of principal plus accrued but unpaid interest of the Unsecured Promissory Notes submitted for cancellation divided by (ii) an amount equal to 80% of the average closing price per share of common stock as quoted on the exchange on

which it principally trades for the 30 day period ending two days prior to the closing date (the AP); plus

(b) For the Warrants, 1.25 new warrants for each Warrant converted, with each new warrant carrying an exercise price equal to 110% of the AP.

On December 14, 2011, the Unsecured Promissory Note holders exchanged $300,000 of principal balance and approximately $43,000 accrued interest for 459,218 common shares and 83,496 warrants.

The Company accounted for this transaction in accordance with ASC 470, *Debt*, as an extinguishment of debt, whereby a gain or loss was calculated as the difference between the reacquisition price and net carrying value of the debt. The reacquisition price was determined as the sum of the fair value of the common stock and new warrants. The warrants were valued using the Black-Scholes fair value model. For the year ended December 31, 2011, a gain of approximately $107,000 was recorded on the transaction based on a reacquisition price of approximately $236,000 and net carrying value, including interest, of approximately $343,000.

As further discussed in Note 4, in the first quarter of 2012, the Company offered the Unsecured Promissory Note holders the opportunity to exchange the common shares plus warrants received from the December 14, 2011 debt exchange for shares of the Series E Convertible Preferred Stock plus warrants under the same terms effected on December 30, 2011. The Company accounted for this transaction as a continuation and settlement of the December 14, 2011 debt modification.

On March 29, 2012, the Unsecured Promissory Note holders exchanged 459,218 common shares and 83,496 warrants for 544,356 shares of Series E Convertible Preferred Stock and 272,178 warrants. For the nine months ended September 30, 2012, a loss of approximately $183,000 was recorded on the transaction based on a reacquisition price of approximately $473,000 and fair value of the equity exchanged of approximately $290,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

3. Issuance of Debt — continued

c. ***Secured Promissory Notes***

In April 2011, the Company raised $2,770,000 from 24 investors, of which 11 were directors, officers, consultants or employees of the Company at the time of issuance, pursuant to a series of secured promissory notes (Secured Promissory Notes). The Secured Promissory Notes are for a term of three years and provide for interest of ten percent (10.0%) per annum to be paid in cash quarterly. Additional consideration was paid to the lenders at closing comprising warrants to purchase shares of the common stock of the Company at a price per share equal to 85% of the Company's stock price at the closing date (the Warrants). 86 Warrants were issued for each $1,000 invested. A total of 238,220 Warrants were issued. The Warrants issued to directors, officers, consultants and employees (Insider Warrants) of the Company provide that the Insider Warrants will not be exercisable unless first approved by the Company's shareholders. These notes are secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of MC, together with all proceeds, rents, profits and returns of and from any of the foregoing. Also, beginning on the date which is one year from the issuance date, if there is an equity financing of the Company resulting in gross proceeds of at least $15,000,000 in new money, holders shall have the option to put 50% of Secured Promissory Notes originally purchased back to the Company, for an amount equal to the principal plus accrued but unpaid interest, on 30 day written notice. The Secured Promissory Notes were issued in two tranches, one closed on April 7, 2011 for $2,470,000 and the other closed on April 21, 2011 for $300,000.

The total proceeds raised in the transaction above were accounted for as an issuance of debt with warrants and have been allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the Secured Promissory Notes received was $420,000, which was recorded as a discount on the debt and applied against the Secured Promissory Notes.

On October 11, 2011, the Company repurchased a $100,000 Secured Promissory Note from a former officer and director in connection with his separation from the Company.

On November 16, 2011, the Company entered into exchange agreements with certain Secured Promissory Note holders whereby the Note holders agreed to exchange the Secured Promissory Notes and Warrants for common shares and new warrants to purchase common shares of the Company as follows:

(a) For the Secured Promissory Notes, a number of new shares of common stock equal to (i) the total amount of principal plus accrued but unpaid interest of the Secured Promissory Notes submitted for cancellation divided by (ii) an amount equal to 80% of the average closing price per share of common stock as quoted on the exchange on which it principally trades for the 30 day period ending two days prior to the closing date (the AP); plus

(b) For the Warrants, 1.25 new warrants for each Warrant converted, with each new warrant carrying an exercise price equal to 110% of the AP.

On November 16, 2011, fifteen Secured Promissory Note holders agreed to exchange $1,750,000 principal balance of the Secured Promissory Notes plus approximately $22,000 accrued interest for 2,373,505 shares of common stock and 188,126 warrants.

The Company accounted for this transaction in accordance with ASC 470, *Debt*, as an extinguishment of debt, whereby a gain or loss was calculated as the difference between the reacquisition price and net carrying value of the debt. The reacquisition price was determined as the sum of the fair value of the common stock and new warrants less the fair value of the original Warrants. The warrants were valued using the Black-Scholes fair value model. For the year ended December 31, 2011, a loss of approximately $1,134,000 was recorded on the transaction based on a reacquisition price of approximately $2,688,000 and net carrying value, including interest, of approximately $1,554,000.

As further discussed in Note 4, in the first quarter of 2012, the Company offered the Secured Promissory Note holders the opportunity to exchange the common shares plus warrants received from the November 16, 2011 debt exchange for shares of the Series E Convertible Preferred Stock plus warrants under the same terms effected on December 30, 2011(the Series E Exchange). The Secured Promissory Note holders who did not participate in the November 16, 2011 exchange are also eligible to participate in the Series E Exchange which expires on May 15, 2012. The Company accounted for this transaction as a continuation and settlement of the November 16, 2011 debt modification.

On May 15, 2012, the Secured Promissory Note holders exchanged 2,102,247 common shares and 166,626 warrants for 2,491,994 shares of Series E Convertible Preferred Stock and 1,245,997 warrants. For the nine months ended September 30, 2012, a loss of approximately $735,000 was recorded on the transaction based on a reacquisition price of approximately $2,415,000 and fair value of the equity exchanged of approximately $1,680,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

3. Issuance of Debt — continued

2012 Merriman Equity Lending Note

On August 31, 2012, the Company's Chief Executive Officer, D. Jonathan Merriman, invested $175,000 in a three year secured equity lending note (2012 Merriman Equity Lending Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing.

Additional consideration in the form of 69,444 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender. The warrants expire on August 31, 2015.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the 2012 Merriman Equity Lending Note was $13,000 which was recorded as a discount on the debt and applied against the 2012 Merriman Equity Lending Note.

August 2012 Chez Secured Promissory Note

On August 31, 2012, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $250,000 in a three year secured promissory note (August 2012 Chez Secured Promissory Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing. Additional consideration in the form of 99,206 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender. The warrants expire on August 31, 2015.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the August 2012 Chez Secured Promissory Note was $19,000 which was recorded as a discount on the debt and applied against the August 2012 Chez Secured Promissory Note.

September 2012 Chez Secured Promissory Note

On September 27, 2012, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $125,000 in a three year secured promissory note (September 2012 Chez Secured Promissory Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing. Additional consideration in the form of 236,250 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender. The warrants expire on September 27, 2015.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the September 2012 Chez Secured Promissory Note was $45,000 which was recorded as a discount on the debt and applied against the September 2012 Chez Secured Promissory Note.

3. Issuance of Debt — continued

d. 2011 Chez Secured Promissory Note

On April 7, 2011, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $330,000 in a three year secured promissory note (2011 Chez Secured Promissory Note) at an interest rate of six percent (6%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing. Also, beginning on the date which is one year from the issuance date, if there is an equity financing of the Company resulting in gross proceeds of at least $15,000,000 in new money, holders shall have the option to put 50% of Secured Promissory Notes originally purchased back to the Company, for an amount equal to the principal plus accrued but unpaid interest, on 30 days written notice.

On November 16, 2011, the 2011 Chez Secured Promissory Note plus accrued interest of $3,000 was exchanged for 445,299 shares of common stock of the Company calculated as (i) the total amount of principal plus accrued but unpaid interest divided by (ii) an amount equal to 80% of the average closing price per share of common stock as quoted on the exchange on which it principally trades for the 30 day period ending two days prior to the closing date.

The Company accounted for this transaction in accordance with ASC 470, *Debt*, as an extinguishment of debt, whereby a gain or loss was calculated as the difference between the reacquisition price and net carrying value of the debt. The reacquisition price was determined as the sum of the fair value of the common stock and new warrants. The warrants were valued using the Black-Scholes fair value model. For the year ended December 31, 2011, a loss of $157,000 was recorded on the transaction based on a reacquisition price of $490,000 and net carrying value, including interest, of $333,000.

As further discussed in Note 4, in the first quarter of 2012, the Company offered Ronald L. Chez the opportunity to exchange the common shares plus warrants received from the November 16, 2011 debt exchange for shares of the Series E Convertible Preferred Stock plus warrants under the same terms effected on December 30, 2011. The Company accounted for this transaction as a continuation and settlement of the November 16, 2011 debt modification.

On May 15, 2012, Ronald L. Chez exchanged 445,299 common shares for 527,856 shares of Series E Convertible Preferred Stock and 263,928 warrants. For the nine months ended September 30, 2012, a loss of approximately $169,000 loss was recorded on the transaction based on a reacquisition price of approximately $512,000 and fair value of the equity exchanged of approximately $343,000. As of September 30, 2012, this note was settled in full.

e. ***Temporary Subordinated Loans***

During the nine months ended September 30, 2012 and 2011, the Company issued loans in the form of temporary subordinated loans to supplement MC's net capital enabling it to underwrite initial public offerings, in accordance with Rule 15c3-1 of the Securities Exchange Act of 1934. Temporary subordinated loan transactions are disclosed separately in Note 10 – Related Party Transactions. All temporary subordinated loans were fully repaid as of September 30, 2012.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

4. Shareholders' Equity

Series D Convertible Preferred Stock

For the nine months ended September 30, 2012, 930,232 shares of Series D Convertible Preferred Stock were converted to 317,460 shares of common stock.

Series E Convertible Preferred Stock

During the nine months ended September 30, 2012 and on December 30, 2011, the Company issued 729,483 and 2,531,744 shares of Series E Convertible Preferred Stock at $0.63 per share plus 364,740 and 1,265,874 warrants, respectively, to purchase the Company's common stock with an exercise price of $0.63 per share.

The warrants expire five years from the effective date. Total proceeds of $459,576 and $1,595,000 for the nine months ended September 30, 2012 and for December 31, 2011, respectively, were allocated between the Series E Convertible Preferred Stock and the related warrants based on the relative fair values of each instrument at the time of issuance.

The Series E Convertible Preferred Stock carries a dividend rate of 9% per annum, such dividends will be paid only when, if and as declared by the Board of Directors and will accumulate until paid. The Company is prohibited from paying any dividends on the Common Stock until all accrued dividends on the Series D and Series E Convertible Preferred Stock are first paid.

The holders of Series E Convertible Preferred Stock are entitled to a liquidation preference payment of $0.63 per share of Series E Convertible Preferred Stock plus all accrued but unpaid dividends on such shares prior and in preference to any payment to holders of the Common Stock upon a merger, acquisition, sale of substantially all the assets, or certain other liquidation events of the Company. Any proceeds after payment of the liquidation preference payment shall be

paid pro rata to the holders of the Series D and E Convertible Preferred Stock and Common Stock on an as converted to Common Stock basis.

Common Stock Exchange Offer

As discussed in Note 3 – Issuance of Debt, on December 14, 2011 and November 16, 2011, four Unsecured Promissory Note holders and fifteen Secured Promissory Note holders, respectively, exchanged the principal balances of their notes plus accrued interests for shares of the Company's common stock and warrants.

In the first quarter of 2012, the Company offered these shareholders the opportunity to exchange the common shares resulted from the note exchange for shares of the Series E Convertible Preferred Stock under the same terms effected on December 30, 2011 (the Series E Exchange). The Secured Promissory Note holders who did not participate in the November 2011 exchange are also eligible to participate in the Series E Exchange which expires on May 15, 2012.

On March 29, 2012, the Unsecured Promissory Note holders exchanged 459,218 common shares and 83,496 warrants for 544,356 shares of Series E Convertible Preferred Stock and 272,178 warrants. For the nine months ended September 30, 2012, a loss of approximately $183,000 was recorded on the transaction based on a reacquisition price of approximately $473,000 and fair value of the equity exchanged of approximately $290,000.

On May 15, 2012, the Secured Promissory Note holders and Ronald L. Chez exchanged 2,102,247 and 445,299 common shares and 166,626 warrants for 2,491,994 and 527,856 shares of Series E Convertible Preferred Stock and 1,245,997 and 263,928 warrants, respectively. For the nine months ended September 30, 2012, losses in the amounts of approximately $735,000 and $169,000 were recorded on the transaction based on a reacquisition price of approximately $2,415,000 and $512,000 and fair value of the equity exchanged of approximately $1,680,000 and $343,000, respectively.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

4. Shareholders' Equity — continued

Option Forfeiture/Cancellation

Due to recent market performance, many of the Company's outstanding options carry exercise prices that are significantly higher than the current market price of the Company's common stock. As a result, in March 2012, the Company offered those option holders who are current officers and employees the ability to return their options to the Company.

The option holders were under no obligation to participate. Option holders who chose to return their options would be considered for new option grants which take into consideration their current positions with the Company, their potential contribution to building the Company's business, and the Company's stock price at the time of grant. There is no guarantee that (a) option holders who returned options will receive new grants, (b) any new option grants will be for the same number of shares as those relinquished, and (c) the new terms will be the same as those of the relinquished options.

As of September 30, 2012, eight option holders consented to relinquish their rights in their 947,178 currently held options. The Company accounted for this transaction in accordance with the guidance of ASC 718-20 *Compensation – Stock Compensation* which states that a cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration. Accordingly, approximately $1,075,000 of unamortized stock based compensation expense related to the forfeited options as of the cancellation date was expensed and included in the Company's condensed consolidated statement of operations for the nine months ended September 30, 2012.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

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5. Stock-based Compensation Expense

Stock Options

In 2009, the Company, with shareholders' approval, adopted the 2009 Stock Incentive Plan (the "2009 Plan"). Up to 1,142,857 new shares of its common stock may be issued pursuant to awards granted under the 2009 Plan. The Company no longer grants options under any of its prior option plans. Any shares of the Company's common stock which become available for new grant, upon the termination of employees holding unvested option grants under existing plans, will be added to the 2009 Plan.

The 2009 Plan, 1999 Stock Option Plan, 2000 Stock Option and Incentive Plan, 2001 Stock Option and Incentive Plan, 2003 Stock Option and Incentive Plan, 2004 Non-Qualified Stock Option and Inducement Plan and 2006 Directors' Stock Option and Incentive Plan, collectively the Option Plans, permit the Company to grant employees, outside directors, and consultants incentive stock options, nonqualified stock options or stock purchase rights to purchase shares of the Company's common stock. The Option Plans do not permit the exercise of restricted stock options, and therefore as of September 30, 2012 and December 31, 2011, there were no shares subject to repurchase.

As of September 30, 2012, there were 6,775,584 shares authorized for issuance under the Option Plans, and 87,551 shares authorized for issuance outside of the Option Plans. As of September 30, 2012, 2,219,127 shares were available for future option grants under the Option Plans. There were no shares available for future option grants outside of the Option Plans. Compensation expense for stock options during the three and nine months ended September 30, 2012 was approximately $141,000 and $1,425,000, respectively. Compensation expense for stock options during the three and nine months ended September 30, 2011 was approximately $49,000 and $665,000, respectively.

On March 23, 2012, the Company's Board of Directors approved the 2012 Stock Incentive Plan (the 2012 Plan). Awards may be made under the 2012 Plan for up to 4,619,669 shares of the Company's common stock. Restricted stock and option grants were made on March 23, 2012, May 31, 2012 and August 7, 2012 under the 2012 Plan.

The following table is a summary of the Company's stock option activity for the nine months ended September 30, 2012:

	Shares	Weighted-Average Exercise Price
Outstanding at December 31, 2011	929,646	$ 6.18
Granted	3,150,000	0.47
Exercised	-	-
Cancelled	(1,039,114)	(3.64)
Outstanding at September 30, 2012	3,040,532	$ 0.59
Exercisable at September 30, 2012	283,024	$ 1.54
Vested and expected to vest as of September 30, 2012	2,600,281	

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

5. Stock-based Compensation Expense — continued

During the nine months ended September 30, 2012, the Company granted 3,150,000 stock options. The options have a 10 year life and fair value of $1,752,000.

As of September 30, 2012, total unrecognized compensation expense related to unvested stock options was approximately $963,000. This amount is expected to be recognized as expense over a weighted-average period of 2.43 years.

The weighted average fair value of each stock option granted for the three and nine months ended September 30, 2012 was $0.40 and $0.47, respectively. The weighted average fair value of each stock option granted for the three and nine months ended September 30, 2011 was $1.54 and $2.05, respectively. The fair value of each option award is estimated on the date of grant using the Black-Scholes stock option pricing model, with the following assumptions for the nine months ended September 30, 2012:

	Three Months Ended 30-Sep-12		Nine Months Ended 30-Sep-12	
Expected Volatility	142.10	%	140.31	%
Average expected term (years)	10.00		4.95	
Risk-free interest rate	60.00	%	65.91	%
Dividend yield	-		-	

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

5. Stock-based Compensation Expense — continued

Restricted Stock

At the date of grant, the recipients of restricted stock have most of the rights of a stockholder other than voting rights, subject to certain restrictions on transferability and a risk of forfeiture. Restricted shares typically vest over a two to four year period beginning on the date of grant. The fair value of each restricted stock award is based on the market value of the Company's stock on the date of grant. The Company recognizes the compensation expense for restricted stock on a straight-line basis over the requisite service period.

During the nine months ended September 30, 2012, the Company granted 1,102,259 shares of restricted stock with a fair value of $589,000.

Compensation expense for restricted stock during the three and nine months ended September 30, 2012 was approximately $38,000 and $625,000, respectively. Compensation expense for restricted stock during the three and nine months ended September 30, 2011 was approximately $48,000 and $61,000, respectively.

The following table is a summary of the Company's restricted stock activity for the nine months ended September 30, 2012:

	Restricted Stock Outstanding	Weighted-Average Grant Date Fair Value
Balance as of December 31, 2011	70,605	$ 2.12
Granted	1,102,259	0.53
Vested	(852,259)	(0.64)

Cancelled	-	-
Balance as of September 30, 2012	320,605	$ 0.59

The weighted average fair value of the restricted stock granted under the Company's stock option plans for the three and nine months ended September 30, 2012 was $0.53 per share. The weighted average fair value of the restricted stock granted under the Company's stock option plans for the three and nine months ended September 30, 2011 was $2.04 per share.

As of September 30, 2012, total unrecognized compensation expense related to restricted stock was approximately $55,000. This expense is expected to be recognized over a weighted-average period of 0.59 years.

Board of Directors Compensation

In 2009, the Company formed a Strategic Advisory Committee of the Board of Directors chaired by Ronald L. Chez, the lead investor in the Series D Convertible Preferred Stock strategic transaction. During the first year, the Chairman of the Committee was compensated with five-year warrants to purchase 42,857 shares the Company’s common stock at $4.55 to be issued pro rata on a monthly basis from September 2009 to September 2010. No other compensation was provided for his service on the Committee.

On January 21, 2011, the Company entered into an amended agreement with Mr. Chez restricting the exercise of the 42,857 warrants without prior shareholders’ approval. This amendment was intended to comply with guidance received from the NASDAQ Capital Market staff. As the Company is no longer traded on the NASDAQ Capital Market, the shareholder approval requirement of the warrants was removed on August 7, 2012.

Non-employee directors currently receive $30,000 per year for Board services. Mr. Ronald L. Chez, as non-employee co-chairman of the Board of Directors received $40,000 and 139,535 shares of common stock with a fair value of $60,000 for his services for the period from September 1, 2011 to August 31, 2012.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

6. 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. Interest and dividends are also not considered since including them in the calculation of diluted loss per share would be anti-dilutive.

Our Board of Directors has the authority to issue up to 300,000,000 shares of common stock and to issue options and warrants to purchase shares of our common stock without stockholder approval in certain circumstances.

The table below represents a list of potentially dilutive securities outstanding as of September 30, 2012 and 2011:

	September 30,	
	2012	2011
Series D convertible preferred stock warrants	3,388,677	3,388,677
Conversion of Series D preferred stock	6,358,872	2,794,743
Series E convertible preferred stock warrants	3,817,621	-
Conversion of Series E preferred stock	6,825,433	-
Stock options	3,040,532	1,271,712
Warrants issued in connection with Secured Promissory Notes	87,720	238,220
Other outstanding warrants	759,286	759,286
Common stock payable for legal settlement	-	2,374
Potentially dilutive securities oustanding	24,278,141	8,455,012

7. 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, 2012, MC had regulatory net capital, as defined, of approximately $798,000 which exceeded the amount required by approximately $548,000. 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.

As further discussed in Note 12, during the three months ended September 30 2012, the Company made capital contributions to MC totaling approximately $485,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

8. Contingencies

Legal Proceedings

Del Biaggio/Cacchione Matters

A number of lawsuits were filed against the Company and its broker dealer subsidiary, MC (collectively, "Merriman Parties"), in connection with the actions of William Del Biaggio III (Del Biaggio), a former customer of the Company and David Scott Cacchione (Cacchione), a former retail broker of the Company. Del Biaggio and Cacchione plead guilty to securities fraud and were subsequently imprisoned.

The majority of these lawsuits have been settled or dismissed. The remaining lawsuits against the Company in connection with Cacchione's activities are as follows:

Trustee for the Bankruptcy estates of William James "Boots" Del Biaggio and BDB Management, LLC v. Merriman Capital, Inc. and D. Jonathan Merriman.

On September 2, 2011, a complaint was filed in FINRA arbitration against MC and D. Jonathan Merriman by the bankruptcy estates of William James "Boots" Del Biaggio III and BDB Management, LLC. The complaint alleges various causes of action arising from alleged unauthorized trading and cross collateralization in plaintiff's accounts at MC and seeks damages of $7.2 million. MC believes that it has valid defenses and intends to contest these claims vigorously. On November 2, 2011, MC filed an answer to the complaint on behalf of MC and D. Jonathan Merriman, denying the allegations and asserting, among other things, the right to set off damages caused to the Merriman Parties by Del Biaggio, who is currently serving an eight year sentence in federal prison for fraud, in an amount well in excess of plaintiff's alleged damages. An arbitration hearing was set for August 2012 but was postponed at plaintiff's request. Arbitration is now scheduled for February 2013. MC believes it has meritorious defenses and intends to contest these claims vigorously. Since MC believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

Khachaturian, Peterson and Salvi v. Merriman Capital, Inc. and Merriman Holdings, Inc.

Complaints were filed in the San Francisco County Superior Court, California, by Henry Khachaturian in January 2011, by Chuck Peterson in February 2010 and by Dolores Salvi in October 2010. The complaints also named as defendants the Company's officers and former officers D. Jonathan Merriman, Gregory Curhan, and Robert Ford. Messrs Curhan and Ford were dropped from the case in January 2011. The complaints were consolidated into one case in March 2011. The complaints allege that plaintiffs were convinced by the Company to purchase shares of a small, risky stock in which the Company held a position. It further alleges that the Company's broker dealer subsidiary, Merriman Capital, Inc. did not permit plaintiffs to sell the shares when the stock's price fell. The complaints seek unspecified compensatory and punitive damages. The Company believes it has meritorious defenses and intends to contest these claims vigorously. Since the Company believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

Wesley Rusch

Unrelated to the Del Biaggio/ Cacchione matters, on July 6, 2012, a complaint was filed in FINRA arbitration by a former employee for employment related claims. The complaint seeks $620,000 in compensatory damages plus unspecified punitive damages. The claims were previously fully arbitrated and decided in the Company's favor. The Company believes it has meritorious defenses and intends to contest these claims vigorously. Since the Company believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

For the nine months ended September 30, 2012, the Company incurred legal expenses of $495,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

9. Related Party Transactions

Sale of Note and Trade Receivables

On September 28, 2012, the Company sold a certain note receivable with a value of $125,000 to Ronald L. Chez, its Co-Chairman of the Board of Directors for $125,000 plus all accrued but unpaid interests. Mr. Chez assumed the risk of collection with respect to the note receivable he purchased.

On February 14, 2012, the Company sold certain trade receivables with a value of $507,000 at a discount to Ronald L. Chez, its Co-Chairman of the Board of Directors for $500,000. Mr. Chez assumed the risk of collection with respect to the receivables he purchased. The $7,000 discount was included in cost of underwriting capital in the Company's condensed consolidated statement of operations.

Temporary Subordinated Borrowings

On June 12, 2012, the Company borrowed $1,600,000 from Ronald L. Chez, its Co-Chairman of the Board of Directors. 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 $36,000, which amount was included in cost of underwriting capital in the Company's consolidated statement of operations. The loan and related fees were paid in full on June 25, 2012.

On January 26, 2012, the Company borrowed $2,500,000 from Ronald L. Chez, its Co-Chairman of the Board of Directors. 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 $110,000, which amount was included in cost of underwriting capital in the Company's consolidated statement of operations. The loan and related fees were paid in full on February 17, 2012.

Subordinated Notes Payable

As further discussed in Note 3, on September 29, 2010, the Company borrowed $1,000,000 from nine individual lenders, all of whom were directors, officers or employees of the Company at the time of issuance.

As of September 30, 2012, $880,000 of the Subordinated Notes, net of approximately $70,000 discount, remain outstanding and is included in notes payable to related parties in the Company's consolidated statements of financial condition. The remaining Subordinated Notes held by parties no longer related to the Company of $46,000, net of approximately $4,000 discount, are included in notes payable in the Company's condensed consolidated statements of financial condition.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

9. Related Party Transactions – continued

Secured Promissory Notes

As further discussed in Note 3, in April 2011, the Company raised $2,770,000 from 24 investors, of which 11 were directors, officers, consultants or employees of the Company at the time of issuance.

On October 11, 2011, the Company repurchased a $100,000 Secured Promissory Note from a former officer and director in connection with his separation from the Company.

On November 16, 2011, the Company entered into exchange agreements with certain Secured Promissory Note investors whereby the investors agree to exchange the Secured Promissory Notes and Warrants for shares of common stock and new warrants to purchase shares of common stock of the Company as follows:

(c) For the Secured Promissory Notes, a number of new shares of common stock equal to (i) the total amount of principal plus accrued but unpaid interest of the Secured Promissory Notes submitted for cancellation divided by (ii) an amount equal to 80% of the average closing price per share of common stock as quoted on the exchange on which it principally trades for the 30 day period ending two days prior to the closing date (the AP); plus

(d) For the Warrants, 1.25 new warrants for each Warrant converted, with each new warrant carrying an exercise price equal to 110% of the AP.

On November 16, 2011, fifteen Secured Promissory Note holders agreed to exchange $1,750,000 principal balance of the Secured Promissory Notes plus approximately $22,000 accrued interest for 2,373,505 shares of common stock and 188,126 warrants.

The Company accounted for this transaction in accordance with ASC 470, *Debt*, as an extinguishment of debt, whereby a gain or loss was calculated as the difference between the reacquisition price and net carrying value of the debt. The reacquisition price was determined as the sum of the fair value of the common stock and new warrants less the fair value of the original Warrants. The warrants were valued using the Black-Scholes fair value model. For the year ended December 31, 2011, a loss of approximately $1,134,000 was recorded on the transaction based on a reacquisition price of approximately $2,688,000 and net carrying value, including interest, of approximately $1,554,000.

As further discussed in Note 4, in the first quarter of 2012, the Company offered the Secured Promissory Note holders the opportunity to exchange the common shares plus warrants received from the November 16, 2011 debt exchange for shares of the Series E Convertible Preferred Stock plus warrants under the same terms effected on December 30, 2011(the Series E Exchange). The Secured Promissory Note holders who did not participate in the November 16, 2011 exchange are also eligible to participate in the Series E Exchange which expires on May 15, 2012.

On May 15, 2012, the Secured Promissory Note holders exchanged 2,102,247 common shares and 166,626 warrants for 2,491,994 shares of Series E Convertible Preferred Stock and 1,245,997 warrants. For the nine months ended September 30, 2012, a loss of approximately $735,000 was recorded on the transaction based on a reacquisition price of approximately $2,415,000 and fair value of the equity exchanged of approximately $1,680,000.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

9. Related Party Transactions – continued

2012 Merriman Equity Lending Note

On August 31, 2012, the Company's Chief Executive Officer, D. Jonathan Merriman, invested $175,000 in a three year secured equity lending note (2012 Merriman Equity Lending Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing.

Additional consideration in the form of 69,444 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the 2012 Merriman Equity Lending Note was $13,000 which was recorded as a discount on the debt and applied against the 2012 Merriman Equity Lending Note.

August 2012 Chez Secured Promissory Note

On August 31, 2012, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $250,000 in a three year secured promissory note (August 2012 Chez Secured Promissory Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing. Additional consideration in the form of 99,206 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the August 2012 Chez Secured Promissory Note was $19,000 which was recorded as a discount on the debt and applied against the August 2012 Chez Secured Promissory Note.

September 2012 Chez Secured Promissory Note

On September 27, 2012, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $125,000 in a three year secured promissory note (September 2012 Chez Secured Promissory Note) at an interest rate of eight percent (8%) per annum payable quarterly in arrears. This note is secured by a security interest in and right of setoff against all of such the Company's right, title and interest in, to all of the capital stock of Merriman Capital Inc., together with all proceeds, rents, profits and returns of and from any of the foregoing. Additional consideration in the form of 236,250 warrants to purchase common shares of the Company at $0.63 per share was issued to the lender.

This transaction was accounted for as an issuance of debt with warrants and the proceeds were allocated to the individual instruments based on the relative fair values of each instrument at the time of issuance. Based on the fair value allocation method, the value of the warrants issued in connection with the September 2012 Chez Secured Promissory Note was $45,000 which was recorded as a discount on the debt and applied against the September 2012 Chez Secured Promissory Note.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

9. Related Party Transactions – continued

2011 Chez Secured Promissory Note

As further discussed in Note 3, on April 7, 2011, the Company's Co-Chairman of the Board of Directors, Ronald L. Chez, invested $330,000 in a three year secured promissory note (2011 Chez Secured Promissory Note) at an interest rate of six percent (6%) per annum payable quarterly.

On November 16, 2011, the 2011 Chez Secured Promissory Note plus accrued interest of $3,000 was exchanged for 445,299 shares of common stock of the Company calculated as (i) the total amount of principal plus accrued but unpaid interest divided by (ii) an amount equal to 80% of the average closing price per share of common stock as quoted on the exchange on which it principally trades for the 30 day period ending two days prior to the closing date.

The Company accounted for this transaction in accordance with ASC 470, *Debt*, as an extinguishment of debt, whereby a gain or loss was calculated as the difference between the reacquisition price and net carrying value of the debt. The reacquisition price was determined as the sum of the fair value of the common stock and new warrants. The warrants were valued using the Black-Scholes fair value model. For the year ended December 31, 2011, a loss of approximately $157,000 was recorded on the transaction based on a reacquisition price of approximately $490,000 and net carrying value, including interest, of approximately $333,000.

As further discussed in Note 4, in the first quarter of 2012, the Company offered Ronald L. Chez the opportunity to exchange the common shares plus warrants received from the November 16, 2011 debt exchange for shares of the Series E Convertible Preferred Stock plus warrants under the same terms effected on December 30, 2011.

On May 15, 2012, Ronald L. Chez exchanged 445,299 common shares for 527,856 shares of Series E Convertible Preferred Stock and 263,928 warrants. For the nine months ended September 30, 2012, a loss of approximately $169,000 was recorded on the transaction based on a reacquisition price of approximately $512,000 and fair value of the equity exchanged of approximately $343,000.

Series E Convertible Preferred Stock

All members of the Company's Board of Directors were investors in the Series E Convertible Preferred Stock transaction effected on December 30, 2011 and July 27, 2012. See Notes 4 and 12 for further details.

MERRIMAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

10. Segment Reporting

In January 2011, MC formed a new investment banking division, Riverbank Partners (Riverbank), to assist corporate issuers in raising capital through a network of independent investment bankers. Also, in January 2011, the Company repositioned its Capital Market Advisory Services (CMAG) in assisting its clients to obtain listing on OTCQX, a tier of Pink Sheets. On January 1, 2012 the Company changed Riverbank’s name to Financial Entrepreneurial Platform (FEP).

Effective January 1, 2012, 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 which 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 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.

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 September 30		Nine Months September 30,	
	2012	2011	2012	2011
Revenues				
MC	$ 1,706,682	$ 3,857,677	$ 8,054,476	$ 15,422,574
FEP	233,833	7,696	1,125,469	3,184,377
CMAG	515,972	214,601	1,233,552	406,975
Total segment revenues	2,456,487	4,079,974	10,413,497	19,013,926
Consolidation items and elimination	3,020	6,564	30,855	(568)
Consolidated revenues	$ 2,459,507	$ 4,086,538	$ 10,444,352	$ 19,013,358
Segment loss				
MC	$ (1,471,808)	$ (1,784,538)	$ (5,023,782)	$ (4,149,235)
FEP	23,383	(6,945)	110,192	84,620
CMAG	437,416	95,406	744,412	57,500
Total segment loss	(1,011,009)	(1,696,077)	(4,169,178)	(4,007,115)
Consolidation items and elimination	(83,875)	(143,686)	(1,352,180)	(412,122)
Consolidated net loss before income taxes	$ (1,094,884)	$ (1,839,763)	$ (5,521,358)	$ (4,419,237)

MERRIMAN HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED

(unaudited)

11. Revenue Concentration

The Company considers significant revenue concentration to be clients or employees who account for 10% or more of the total revenues generated by the Company during the reporting periods. During the nine months ended September 30, 2012, the Company had one employee and one client who accounted for 23% and 11% of total revenues, respectively. During the nine months ended September 30, 2011, the Company had one employee who accounted for 20% and no client who accounted for 10% or more of total revenues.

12. Subsequent Events

A complaint was filed in federal court for the Southern District of Florida on October 15, 2012 by Francis Howard against Chanticleer Holdings, certain of its officers, Merriman Capital, Inc., Dawson James Securities, Inc., and Creason & Associates P.L.L.C. Plaintiff alleges violations of the Securities Act of 1933 in connection with a public offering by Chanticleer Holdings, Inc. (of which the Company was a co-manager) and seeks class action status. The Company believes it has meritorious defenses and intends to contest these claims vigorously. Since the Company believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

On October 30, 2012, the Company borrowed $500,000 from Ronald L. Chez, its Co-Chairman of the Board of Directors. The loan was in the form of a temporary subordinated loan in accordance with Rule 15c3-1 of the Securities Exchange Act of 1934.

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,” “proj “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 45 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 investment banking, capital markets services, corporate services, and investment banking through its primary operating subsidiary, Merriman Capital, Inc. (hereafter MC). 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.

MC is an investment bank and securities broker-dealer focused on fast-growing companies and institutional investors. 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 are headquartered in San Francisco, with an additional office in New York, NY. As of September 30, 2012, we had 29 employees.

Executive Summary

Our total revenues were approximately $2,460,000 for the three months ended September 30, 2012 representing a 40% decrease over the same period in 2011. The decrease was primarily due to the Company's reorganizing and repositioning of its business segments, including the discontinuance of certain non-profitable businesses and reduction in force. Our commission revenues for the same period decreased 55% year-over-year due to fewer sales producers in 2012. While investment banking revenue decreased 48% year over year due to fewer banking transactions being closed as a result of the Company having fewer bankers, we were able to exceed our budget with a smaller team of professionals. Principal transactions increased 68% from the same period in 2011 primarily due to market volatility. Due to the Company's repositioning its business model to focus on capital markets advisory and platform revenue model, we saw a 117% increase in revenue in those areas. For the three months ended September 30, 2012, net loss from operations was approximately $1,095,000 or $0.25 per share. Net loss from operations for the three months ended September 30, 2012 included stock based compensation expense of approximately $172,000. For the three months ended September 30, 2011, net loss from operations was approximately $1,843,000 or $0.69 per share.

Business Environment

Domestic equity markets during the 3rd quarter 2012 were shaped by a number of issues with the primary focus again being the ongoing European sovereign debt crisis. While this construct remains far from resolved, the markets nonetheless took considerable comfort from the European Central Bank offer of September 6th to buy the debt of troubled Eurozone nations. ECB President Draghi unveiled an open-ended plan to buy securities going out up to three years in maturity. This offer is conditioned upon the receipt of a formal application for such aid along with adoption of fiscal austerity measures.

On the domestic economic front, 2nd quarter 2012 GDP was most recently reported at +1.3% and was quite a bit lower than preliminary reports of +1.8% growth. This further represents substantial decline from 1st quarter growth reported at +2.0%. The unemployment rate, which has been trending down in recent months, was reported at 7.8% by September 2012. Employment appears to be increasing at a slow grind, and should be aided by the Fed's aggressive actions on housing. The Fed initiated another round of quantitative easing ("QE3"), focusing on the housing sector. Unlike previous QE programs, QE3 is open-ended with no pre-determined total package size. Further, the Federal Reserve Bank is continuing its "Operation Twist" originally announced in September 2011; this program aimed squarely at the mortgage markets. While housing market activity remains at levels of roughly 1/3rd of peak activity observed in late 2005, there are good signs of a turn. Building permits were reported above 800 thousand units in July and August for the first time since August 2008. Home values, while still well below pre-crisis peaks, have been recovering a bit in most markets across the nation. Certainly this renewed activity may be attributed in some part to continued record low mortgage rates. At some point, even the banks will begin to lend to consumers again.

Energy stocks led the way in the quarter, advancing some 11%. Energy was followed by technology stocks (+7.71%); consumer discretionary issues (+7.47%); and, financials (+6.95%). The worst performing sector during the 3rd quarter were utility stocks (-0.49%), followed by industrials (+3.25%); consumer staples (+3.87%); and, materials (+4.96%). The index most relevant to our business, the Russell 2000 Growth, was up 4.8% during the quarter.

One of the areas of greatest impact to our Company relates to the dramatic decrease in stock trading volume over the past four years and the particularly sharp declines over the past six months, with the average number of trades across all exchanges at nearly half that of the 2008 peak. Typically, a gradual economic recovery has eventually led to increased volumes, but the high degree of investor skepticism signaled by the fairly consistent equity mutual fund outflows seems to capping both retail activity and pension fund investors. These signs of negative sentiment appear to be providing a positive underpinning to the overall market, but it remains to be seen if solid market performance will eventually bring volumes back. More recently, concerns over the election and the much discussed “Fiscal Cliff” have further frozen both institutional and retail investors. Many of our competitors have exited the business entirely over the past year, but this rationalization of the competitive environment has not broken the massive slowdown in either the commission business or micro cap financings.

Liquidity and Capital Resources

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, 2012, MC had regulatory net capital, as defined, of approximately $798,000 which exceeded the amount required by approximately $548,000.

As of September 30, 2012, liquid assets consisted primarily of cash and cash equivalents of approximately $1,703,000 and marketable securities of approximately $844,000, totaling approximately $2,547,000. For the nine months ended September 30, 2012, the Company had negative cash flows from operations of approximately $3,585,000. The Company incurred substantial loss during the first nine months of 2012, having net loss of approximately $5,521,000. As of September 30, 2012, the Company had an accumulated deficit of approximately $143,569,000. These facts raise substantial doubt as to our ability to continue as a going concern.

Accordingly, the accompanying unaudited 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.

During the third quarter of 2011, the Company began the process of eliminating non-profitable revenue activities and certain discretionary spending. The Company significantly reduced its operating expenses by eliminating certain non-revenue generating personnel, administrative positions and technology related costs. As of September 30, 2012, the Company had 29 full time employees.

Additionally, in the fourth quarter of 2011, the Company shifted its strategic focus away from the traditional broker dealer model of research and institutional sales toward a capital markets advisory and platform revenue model. This represents a more scalable, predictable and profitable model in today’s environment. Management believes this business model will result in reduced fixed operating costs and higher operating profit margin.

While the Company believes its current funds will be sufficient to enable it to meet its planned expenditures through at least March 31, 2013, if anticipated operating results are not achieved, management has the intent and believes it has the ability to delay or reduce expenditures. 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.

Management’s plan to alleviate the going concern uncertainty include, but are not limited to, the issuance of equity and debt instruments for working capital. The Company’s continued existence is also dependent upon its ability to increase revenues generated from operations which will enable the Company to achieve a profitable level of operations and/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, 2012 and 2011:

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Revenues				
Commissions	$1,716,268	$3,834,121	$4,615,763	$10,821,486
Principal transactions	(294,326)	(910,382)	(277,428)	(417,399)
Investment banking	468,010	900,879	4,690,879	8,051,512
Advisory and other	569,555	261,920	1,415,138	557,759
Total revenues	2,459,507	4,086,538	10,444,352	19,013,358
Operating expenses				
Compensation and benefits	2,108,096	3,169,959	7,612,279	14,554,357
Stock-based compensation	171,604	59,646	2,048,313	598,151
Brokerage and clearing fees	158,199	326,236	438,782	1,087,182
Professional services	80,726	363,816	535,112	1,127,193
Occupancy and equipment	420,746	483,834	1,307,823	1,407,554
Communications and technology	240,808	491,197	815,202	1,499,666
Depreciation and amortization	5,590	20,755	16,530	117,160
Travel and entertainment	104,304	200,411	306,556	747,028
Legal services and litigation settlement expense	159,544	104,322	495,329	549,681
Cost of underwriting capital	-	-	152,600	97,625
Other	9,971	549,988	901,475	1,346,051
Total operating expenses	3,459,588	5,770,164	14,630,001	23,131,648
Operating loss	(1,000,081)	(1,683,626)	(4,185,649)	(4,118,290)
Other income	-	15,000	15,000	26,601
Interest income	-	-	1,763	3,938
Interest expense	(64,513)	(121,574)	(179,116)	(286,364)
Amortization of debt discount	(30,290)	(49,563)	(87,027)	(45,122)
Loss on equity exchange	-	-	(1,086,329)	-
Net loss before income taxes	(1,094,884)	(1,839,763)	(5,521,358)	(4,419,237)
Income tax benefit (expense)	-	(2,763)	-	(6,107)

Net loss	(1,094,884)	(1,842,526)	(5,521,358)	(4,425,344)
Preferred stock cash dividend	-	(129,433)	-	(407,212)
Net loss attributable to common shareholders	$(1,094,884)	$(1,971,959)	$(5,521,358)	$(4,832,556)

Total revenues during the third quarter of 2012 decreased by approximately $1,627,000, or 40% compared to the same period in 2011. The decrease consisted of approximately $2,118,000 in lower commissions and $433,000 in lower investment banking revenues, partially offset by $616,000 and $308,000 increases in principal transactions and other revenues, respectively.

The 117% increase in other revenues was primarily due to the expansion of our CMAG services as we sponsored more companies in the OTCQX Markets.

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, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenue				
Capital raising	$ 336,843	$ 700,879	$ 3,440,112	$ 6,212,891
Financial advisory	131,167	200,000	1,250,767	1,838,621
Total investment banking revenue	$ 468,010	$ 900,879	$ 4,690,879	$ 8,051,512
Transaction Volumes				
Public offerings				
Capital underwritten participations	$ 8,550,000	$ 41,400,000	$ 54,350,005	$ 346,963,946
Number of transactions	1	1	5	8
Private placements				
Capital raised	$ 89,000,000	$ 6,942,000	$ 272,210,500	$ 650,611,923
Number of transactions	1	1	7	11
Financial advisory				
Transaction amounts	$ -	$ 101,000,000	$ 125,000,000	$ 160,000,000
Number of transactions	1	1	7	3

Investment banking revenue was approximately $468,000 or 19% of total revenues during the third quarter of 2012, representing a 48% decrease from the same quarter in 2011 primarily due to fewer banking transactions being closed as a result of the Company having fewer bankers in 2012. Of the $468,000 investment banking revenue, approximately $234,000 was generated by FES during the third quarter of 2012.

During the three months ended September 30, 2012 and 2011, there was one investment banking client that accounted for more than 10% of our total revenue.

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,	
	2012	2011	2012	2011
Commissions				
Institutional equities	$ 1,716,268	$ 3,834,121	$ 4,615,763	$ 10,821,486
Total commission revenue	$ 1,716,268	$ 3,834,121	$ 4,615,763	$ 10,821,486
Principal transactions				
Customer principal transactions, proprietary trading and market making	$ 10,179	$ 23,706	$ (129,993)	$ 288,142
Investment portfolio	(304,505)	(934,088)	(147,435)	(705,541)
Total principal transaction revenue	$ (294,326)	$ (910,382)	$ (277,428)	$ (417,399)
Transaction Volumes				
Number of shares traded	93,801,235	147,998,878	294,786,836	430,726,103

Commission revenue was approximately $1,716,000 or 70% of total revenue during the third quarter of 2012, representing a $2,118,000 or 55% decrease from the same period in 2011. The decrease was primarily due to lower trading volume as a result of the Company having fewer sales producers in 2012, as well as the dramatic overall decline in equity trading volumes in the U.S.

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 months ended September 30, 2012, principal transaction losses were approximately $294,000, primarily consisting of a $304,000 unrealized loss on our investment portfolios partially offset by a $10,000 gain from customer principal transactions and proprietary trading and market making. For the same period in 2011, principal transaction losses were approximately $910,000, primarily consisting of a $934,000 unrealized loss on our investment portfolios partially offset by a $24,000 gain from customer principal transactions and proprietary trading and market making.

During the third quarter of 2012, there was one brokerage customer that accounted for more than 10% of our total revenue and there were two in the third quarter of 2011.

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, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Incentive compensation and discretionary bonuses	$ 1,193,571	$ 1,185,304	$ 4,765,579	$ 8,332,437
Salaries and wages	710,649	1,612,601	2,152,912	4,999,836
Payroll taxes, benefits and other	203,876	372,054	693,788	1,222,084
Total compensation and benefits	$ 2,108,096	$ 3,169,959	$ 7,612,279	$ 14,554,357
Cash compensation and benefits as a percentage of core business revenue	77 %	63 %	71 %	75 %

Total compensation and benefits were approximately $2,108,000 and $3,170,000 for the three months ended September 30, 2012 and 2011, respectively, or a decrease of approximately $1,062,000 or 33%. The decrease was primarily due to lower headcount decreasing from 77 at the beginning of 2011 to 29 as of September 30, 2012. During the third quarter of 2011, the Company began the process of eliminating non-profitable revenue activities and certain discretionary spending. The Company significantly reduced its operating expenses by eliminating certain non-revenue generating personnel, administrative positions and technology related costs.

Of the total compensation and benefits for the three months ended September 30, 2012, $210,000 was for FES personnel.

Stock-based compensation expense for the three months ended September 30, 2012 increased $112,000 or 188% from the same period in 2011. The increase was primarily due to options granted toward the end of the second quarter of 2012.

There were four sales professionals who accounted for more than 10% of total revenues during the three months ended September 30, 2012 and two in the same period of 2011.

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 engages 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. Brokerage and clearing fees decreased approximately $168,000 or 52% compared to the same period in 2011 due to decrease in trading volume.

Professional services expense includes audit and accounting fees, expenses related to investment banking transactions, and various consulting fees.

Communications and technology expense includes market data and quote services, voice, data and internet service fees, and data processing costs.

Depreciation and amortization expense relate to the depreciation of our furniture, fixtures, computer equipment and leasehold improvements. Depreciation and amortization are mostly fixed in nature. The decrease of approximately $15,000, or 73% in the third quarter of 2012 over the same period in 2011 resulted from minimal fixed asset additions and the full depreciation of certain assets, reducing the depreciable base of assets.

Travel and business development expenses are incurred by each of our lines of business and include business development costs by investment bankers, travel costs for research analysts to visit the companies that they cover and non-deal road show expenses. Non-deal road shows represent meetings in which management teams of our corporate clients present directly to our institutional investors. The decrease of approximately $96,000, or 48% on a year over year basis is due to lower headcount, fewer deals closed as well as continued cost reduction measures.

Legal service expenses were incurred during the normal course of our business and relate to ongoing litigations. The increase of approximately $55,000 or 53% was due to a pending arbitration being scheduled in October 2012.

Cost of underwriting capital represents borrowing cost of capital to supplement MC's net capital in order to enable it to underwrite banking deals. No costs of underwriting capital were incurred during the three months ended September 30, 2012 and 2011.

Other operating expenses include other taxes, provision for uncollectible accounts receivable, professional liability and property insurance, recruiting fees, regulatory fees and assessment, and other miscellaneous expenses. The decrease of approximately $540,000 or 98% on a year over year basis was primarily due to approximately a $376,000 decrease in other taxes, a $76,000 decrease in professional liability and property insurance premiums due to lower coverage, a $34,000 decrease in provision for uncollectible accounts receivable, and a $54,000 decrease in other miscellaneous expenses.

Off-Balance Sheet Arrangements

We were not a party to any off-balance sheet arrangements during the three months ended September 30, 2012 and 2011. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities and structured finance entities.

Commitments

Other Commitments

The following table summarizes our significant commitments as of September 30, 2012, 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 & Related Interest	Office Leases	Operating Leases	Total
2012	$ 38,208	$425,541	$163,049	$626,798
2013	1,376,712	1,416,113	545,014	3,337,839
2014	944,718	960,000	305,012	2,209,729
2015	-	960,000	30,300	990,300
Thereafter	-	4,624,000	-	4,624,000
Total Commitments	$ 2,359,638	$8,385,654	$1,043,375	$11,788,666
Interest	(439,638)	-	-	(439,638)
Net Commitments	$ 1,920,000	$8,385,654	$1,043,375	$11,349,029

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 consolidated statements of financial condition on a trade-date basis. Related unrealized gains or losses are generally recognized in principal transactions in the consolidated statements of operations. The use of fair value to measure financial instruments is fundamental to our 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.

Option Forfeiture/Cancellation

Due to recent market performance, many of the Company's outstanding options carry exercise prices that are significantly higher than the current market price of the Company's common stock. As a result, in March 2012, the Company offered those option holders who are current officers and employees the ability to return their options to the Company.

The option holders were under no obligation to participate. Option holders who chose to return their options will be considered for new option grants which will take into consideration their current positions with the Company, their potential contribution to building the Company's business, and the Company's stock price at the time of grant. There is no guarantee that (a) option holders who returned options will receive new grants, (b) any new option grants will be for the same number of shares as those relinquished, and (c) the new terms will be the same as those of the relinquished options.

The Company accounted for this transaction in accordance with the guidance of ASC 718-20 *Compensation – Stock Compensation* which states that a cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration.

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, 2012 and 2011 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, 2011. There has been no material change in the quantitative and qualitative disclosure about market risk since December 31, 2011.

ITEM 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to the officers who certify the Company's financial reports and to other members of senior management and the Board of Directors.

Based on their evaluation as of December 31, 2011, the principal executive officer and principal financial officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are not effective because of a material weakness in internal controls over financial reporting related to our finance department as described below.

Management's Report on Internal Control Over Financial Reporting – Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in the Securities Exchange Act of 1934 Rules 13a-15(f), to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the United States Generally Accepted Accounting Principles (U.S. GAAP). The internal control includes policies and procedures to provide reasonable assurance that transactions are properly accounted for in accordance with U.S. GAAP.

Due to its inherent limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. Projections of any evaluation of effectiveness to future periods are subject to the risk that policies and procedures may become inadequate because of changes in conditions, or that the degree of compliance may deteriorate. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. These inherent limitations are taken into consideration in the design of the financial reporting internal control to reduce, though not eliminate, this risk.

Management assessed the effectiveness of our internal control over financial reporting as of December 31, 2011 and based on that evaluation, they concluded that such internal controls and procedures were not effective. The material weakness identified related to deficiencies in the accounting research and reporting functions and the closing and reporting process resulting in improper applications of U.S. GAAP to certain equity and debt transactions and the improper valuation of securities.

Planned Remediation Efforts to Address Material Weakness –Management has determined that its processes and procedures over the accounting research, accounting close and reporting processes were not adequate due to unexpected personnel turnover in the finance department. As a result the Company has brought in a senior financial person and plans to hire additional qualified personnel to remediate the material weakness discussed above.

Management is committed to improving the Company’s internal control over financial reporting processes and will meet frequently with the Audit Committee to monitor and report on the ongoing effectiveness of such remediation activities and controls. The Company expects to complete the required remediation during 2012.

Changes in internal controls

Except as otherwise discussed above, there have been 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) that occurred during the fiscal quarter ended September 30, 2012, 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

Del Biaggio/Cacchione Matters

A number of lawsuits were filed against the Company and its broker dealer subsidiary, MC (collectively, "Merriman Parties"), in connection with the actions of William Del Biaggio III (Del Biaggio), a former customer of the Company and David Scott Cacchione (Cacchione), a former retail broker of the Company. Del Biaggio and Cacchione plead guilty to securities fraud and were subsequently imprisoned.

The majority of these lawsuits have been settled or dismissed. The remaining lawsuits against the Company in connection with Cacchione's activities are as follows:

Trustee for the Bankruptcy estates of William James "Boots" Del Biaggio and BDB Management, LLC v. Merriman Capital, Inc. and D. Jonathan Merriman.

On September 2, 2011, a complaint was filed in FINRA arbitration against MC and D. Jonathan Merriman by the bankruptcy estates of William James "Boots" Del Biaggio III and BDB Management, LLC. The complaint alleges various causes of action arising from alleged unauthorized trading and cross collateralization in plaintiff's accounts at MC and seeks damages of $7.2 million. MC believes that it has valid defenses and intends to contest these claims vigorously. On November 2, 2011, MC filed an answer to the complaint on behalf of MC and D. Jonathan Merriman, denying the allegations and asserting, among other things, the right to set off damages caused to the Merriman Parties by Del Biaggio, who is currently serving an eight year sentence in federal prison for fraud, in an amount well in excess of plaintiff's alleged damages. An arbitration hearing was set for August 2012 but was postponed at plaintiff's request. Arbitration is now scheduled for February 2013. MC believes it has meritorious defenses and intends to contest these claims vigorously. Since MC believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

Khachaturian, Peterson and Salvi v. Merriman Capital, Inc. and Merriman Holdings, Inc.

Complaints were filed in the San Francisco County Superior Court, California, by Henry Khachaturian in January 2011, by Chuck Peterson in February 2010 and by Dolores Salvi in October 2010. The complaints also named as defendants the Company's officers and former officers D. Jonathan Merriman, Gregory Curhan, and Robert Ford. Messrs Curhan and Ford were dropped from the case in January 2011. The complaints were consolidated into one case in March 2011. The complaints allege that plaintiffs were convinced by the Company to purchase shares of a small, risky stock in which the Company held a position. It further alleges that the Company's broker dealer subsidiary, Merriman Capital, Inc. did not permit plaintiffs to sell the shares when the stock's price fell. The complaints seek unspecified compensatory and punitive damages. The Company believes it has meritorious defenses and intends to contest these claims vigorously. Since the Company believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

Wesley Rusch

Unrelated to the Del Biaggio/ Cacchione matters, on July 6, 2012, a complaint was filed in FINRA arbitration by a former employee for employment related claims. The complaint seeks $620,000 in compensatory damages plus unspecified punitive damages. The claims were previously fully arbitrated and decided in the Company's favor. The Company believes it has meritorious defenses and intends to contest these claims vigorously. Since the Company believes that the likelihood of an unfavorable outcome in the case is remote, management has not provided an accrual for this lawsuit as of September 30, 2012.

ITEM 1A. Risk Factors

In addition to the factors set forth below and the other 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, 2011, filed on March 30, 2012, as amended by our Form 10-K/A filed on April 30, 2012.

We may not be able to continue operating our business

The Company incurred significant losses in the nine months ended September 30, 2012 and the year ended December 31, 2011. Even if we are successful in executing our plans, we may not be able to continue sustaining such losses. The Company's ability to meet its financial obligations is highly dependent on market and economic conditions. We also recorded net losses in certain quarters within other past fiscal years.

Prior claims on assets in liquidation

There can be no assurance that there will be any proceeds available in liquidation for our preferred and common shareholders after payments to holders of our Secured and Unsecured Promissory Notes. If there are any proceeds available to shareholders in liquidation, Series D and E convertible preferred shareholders have a liquidation preference over common shareholders.

Series D and E convertible preferred shareholders are entitled to a "liquidation preference payment" of $0.43 and $0.63 per share, respectively, plus all accrued but unpaid dividends, prior and in preference to common shareholders upon a merger, acquisition, sale of substantially all the assets, or certain other liquidation events of the Company.

Common shareholders may receive nothing in liquidation or receive much less than they would if there were no Secured and Unsecured Promissory Notes, Series D and E Convertible Preferred Stock outstanding.

Limitations on our access to capital and our ability to comply with net capital requirements could impair our ability to conduct our business

Liquidity, or ready access to funds, is essential to financial services firms. Failures of financial institutions have often been attributable in large part to insufficient liquidity. Liquidity is of importance to our trading business, and perceived liquidity issues may affect our customers and counterparties' willingness to engage in brokerage transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or operational problems that affect our trading capability.

The Company has historically accessed capital markets to raise money through the sale of equity. Our Series D and E Preferred shareholders have certain rights and restrictive provisions which may affect our ability to continue to raise capital through the issuance of additional common stock.

MC, our broker-dealer subsidiary, is subject to the net capital requirements of the SEC and various self-regulatory organizations of which it is a member. These requirements typically specify the minimum level of net capital a broker-dealer must maintain, and also mandate that a significant part of its assets be kept in relatively liquid form. Any failure to comply with these net capital requirements could impair our ability to conduct our core business. Furthermore, MC is subject to laws that authorize regulatory bodies to prevent or reduce the flow of funds from it to the Company

Factors which could impede our ability to access additional capital include the recent extreme volatility in the equity markets and our recent operating results. If we are not able to access additional capital, we might not be able to meet our obligations in a timely manner, which would have a material adverse effect on the Company's ability to achieve its intended business objectives.

We have incurred losses for the period covered by this report in the recent past and may incur losses in the future.

The Company recorded net losses of approximately $5,521,000 for the nine months ended September 30, 2012 and $8,385,000 for the year ended December 31, 2011. We also recorded net losses in certain quarters within other past fiscal years. We may incur losses in future periods.

Reduced scale of operations and revenues, and changes to business plan

During 2011, the Company significantly reduced the scale of its operations and is executing a new business model. The Company had 77 and 29 employees at January 1, 2011 and September 30, 2012, respectively. The historical business of the firm is outlined in our prior filings with the SEC. There is a risk that the firm will not be able to achieve profitability with this reduced level of productive personnel.

The Company is executing a business plan focusing on its strengths in sponsoring corporate issuers to be listed on the OTCQX market, and on executing securities transactions for institutional investors. There is a risk that the Company may not be able to execute the business plan successfully due to various constraints, including those related to the current capital markets and the lack of adequate financial resources to transition the Company into the new business model.

Possible need for additional capital

As of September 30, 2012, the Company had approximately $4.3 million in current assets, $1.3 million in current liabilities and $0.7 million of equity. Additionally, its broker-dealer subsidiary, MC, is required to maintain a minimum level of net capital in order to conduct its business. MC’s excess net capital as of September 30, 2012 was approximately $498,000. Given the Company’s history of losses, the market volatility and uncertain business environment, there can be no assurance that the Company will have sufficient capital to achieve its intended business objectives.

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 Chief 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.

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, 2012 By: /s/ D. JONATHAN MERRIMAN
D. Jonathan Merriman,
Chief Executive Officer
(Principal Executive Officer)

November 14, 2012 By: /s/ WILLIAM J. FEBBO
William J. Febbo
Principal Financial Officer
(Principal Financial Officer)