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VFINANCE INC  
Form 10KSB  
March 31, 2005

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-KSB

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

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2004

Commission File Number 1-11454-03

VFINANCE, INC.

(Name of Small Business Issuer in Its Charter)

Delaware  
-----  
(State or Other Jurisdiction of  
Incorporation or Organization)

58-1974423  
-----  
(I.R.S. Employer  
Identification No.)

3010 North Military Trail, Suite 300  
Boca Raton, FL 33431  
-----  
(Address of Principal Executive Offices)

(561) 981-1000  
-----  
(Issuer's Telephone Number,  
Including Area Code)

Securities registered under Section 12(b) of the Act: NONE

Securities registered under Section 12(g) of the Act:

COMMON STOCK, PAR VALUE \$0.01 PER SHARE

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

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

The issuer's revenues for the fiscal year ended December 31, 2004 were \$26,329,151

The aggregate market value of the voting stock held by non-affiliates of the issuer on March 28, 2005, based upon the average bid and ask prices of such stock on that date was \$9,500,638. The number of shares of Common Stock of the issuer outstanding as of March 28, 2005 was 40,126,133.

DOCUMENTS INCORPORATED BY  
REFERENCE: NONE

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FORWARD-LOOKING STATEMENTS

The following information provides cautionary statements under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 (the Reform Act). We identify important factors that could cause our actual results to differ materially from those projected in forward-looking statements we make in this report or in other documents that reference this report. All statements that express or involve discussions as to: expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, identified through the use of words or phrases such as we or our management believes, expects, anticipates or hopes and words or phrases such as will result, are expected to, will continue, is anticipated, estimated, projection and outlook, and words of similar import) are not statements of historical facts and may be forward-looking. These forward-looking statements are based largely on our expectations and are subject to a number of risks and uncertainties including, but not limited to, economic, competitive, regulatory, growth strategies, available financing and other factors discussed elsewhere in this report and in the documents filed by us with the Securities and Exchange Commission ("SEC"). Many of these factors are beyond our control. Actual results could differ materially from the forward-looking statements we make in this report or in other documents that reference this report. In light of these risks and uncertainties, there can be no assurance that the results anticipated in the forward-looking information contained in this report or other documents that reference this report will, in fact, occur.

These forward-looking statements involve estimates, assumptions and uncertainties, and, accordingly, actual results could differ materially from those expressed in the forward-looking statements. These uncertainties include, among others, the following: (i), the inability of our broker-dealer operations to operate profitably in the face of intense competition from larger full service and discount brokers; (ii) a general decrease in merger and acquisition activities and our potential inability to receive success fees as a result of transactions not being completed; (iii) increased competition from business development portals; (iv) technological changes; (v) our potential inability to implement our growth strategy through acquisitions or joint ventures; and (vi) our potential inability to secure additional debt or equity financing.

Any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement or statements to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for our management to predict all of such factors, nor can our management assess the impact of each such factor on the business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

PART I

ITEM 1. DESCRIPTION OF BUSINESS.

BUSINESS DEVELOPMENT

vFinance, Inc. is a holding company engaged in the financial services business where our strategic focus is on servicing the needs of high net-worth and institutional investors and high growth companies. Through our principal operating subsidiary, vFinance Investments, Inc., a licensed broker-dealer, we provide investment banking, retail and institutional brokerage services in all 50 states and the District of Columbia. The Company also operates a second broker-dealer, EquityStation, Inc. ("EquityStation") which offers institutional traders, hedge funds and professional traders a suite of services designed to enhance their trading by offering services such as trading technology, routing software, hedge fund incubation, capital introduction and custodial services. The Company, through its website [www.vfinance.com](http://www.vfinance.com), provides financial information services to entrepreneurs and venture investors.

OUR HISTORY. We were incorporated in the state of Delaware in February 1992 under the name Peachtree Fiberoptics, Inc., primarily to engage in the production and sale of plastic optical fiber. On October 27, 1993, we ceased all operations and subsequently sold certain assets relating to our machinery and optical fiber operations.

On November 8, 1999, we acquired vFinance Holdings, Inc., a Florida corporation, and Union Atlantic LC, a Florida limited liability company, through a Share Exchange Agreement. We received all the outstanding capital stock of vFinance Holdings, Inc. and all the outstanding membership interests of Union Atlantic LC in exchange for a total of 6,955,000 shares of our common stock.

On January 4, 2001, we closed the merger of NW Holdings, Inc. ("NWH"), a Florida corporation, with and into us with us as the surviving corporation. On the closing date of the merger, NWH was the parent company of and wholly owned First Level Capital, Inc., a Florida corporation. First Level Capital, Inc. is now known as vFinance Investments, Inc. which has offices in New York, New Jersey and Florida. In addition to these offices the Company has relationships with certain independent contractors located throughout the United States.

On January 4, 2001, we also completed the merger of Colonial Direct Financial Group, Inc., a Delaware corporation, with and into Colonial Acquisition Corp., our wholly owned subsidiary, with Colonial Direct Financial Group, Inc. as the surviving corporation and as our wholly owned subsidiary. At the time of the merger, Colonial Direct Financial Group, Inc. was a holding company comprised of two diversified financial services companies, including First Colonial Securities Group, Inc. and Colonial Direct Retirement Services, Inc., and a company that provides administrative support to these financial service companies, Colonial Direct Capital Management, Inc. On June 22, 2002, the Company's Board of Directors approved a dividend to the Company's Series A Preferred shareholders of all of the common stock of Colonial. Although Colonial is no longer a subsidiary of the Company, the majority of its personnel remained employed with vFinance Investments, Inc.

On August 20, 2001, we entered into a Securities Exchange Agreement by means of which we acquired the membership interests in two related companies, Critical Investments, LLC, a Delaware limited liability company ("Critical Investments"),

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and Critical Advisors, L.L.C., a Virginia limited liability company ("Critical Advisors"). Critical Investments manages Critical Infrastructure Fund, L.P. ("Critical Infrastructure LP"), a Delaware limited partnership. Critical Advisors manages Critical Infrastructure Fund, Ltd. ("Critical Infrastructure Ltd."), an international business company organized and existing under the laws of the British Virgin Islands and receives (i) a management fee equal to 1% of the net asset value of Critical Infrastructure Ltd. and (ii) a performance fee equal to 20% of the increase in net asset value of Critical Infrastructure Ltd. Critical Infrastructure LP and Critical Infrastructure Ltd. are the sole general partners in, owning 96% and 4%, respectively, and conduct their investment and trading activity through Critical Infrastructure Fund (BVI), LP, a limited partnership organized and existing under the laws of the British Virgin Islands, which holds a portfolio of securities. A determination has been made to liquidate the funds. The SEC is conducting a non-public investigation relating to Critical Infrastructure LP, Critical Investments and Critical Advisors. The Company is cooperating with this investigation. Critical Investments and Critical Advisors changed their names to vFinance Investors, LLC and vFinance Advisors, LLC, respectively, subsequent to the acquisition.

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On May 29, 2002, the Company entered into a select asset purchase agreement (the "Agreement"), as amended on June 17, 2002 (the "Amendment"), with Somerset Financial Partners, Inc., ("Somerset") a Delaware corporation to acquire certain of its assets. Through its subsidiaries, Somerset acted as a registered broker dealer and was engaged in other financial services. Pursuant to the Agreement the Company received the transfer of all agreed upon brokerage customers and client accounts as well as the registration of approximately 25 registered personnel of Somerset. As of June 17, 2002, the Company began reflecting in its financial statements the applicable revenue production and other associated costs. Under the escrow agreement signed in conjunction with the Agreement and Amendment, the Company instructed its transfer agent to deliver to and in the name of its escrow agent a total of 3,000,000 shares of the Company's common stock (the "Escrowed Shares"). The Escrowed Shares were to be delivered to Somerset when Somerset achieves all the closing conditions. In August 2002, all of the closing conditions of the Agreement and Amendment were not met by Somerset and the Company issued a default letter to Somerset (the "Default Letter"). Among other things, the Default Letter provided formal notice to Somerset of its default under the Agreement and Amendment. In October 2002, a formal termination notice was executed by the Company and Somerset and the Escrowed Shares were returned to the Company and cancelled.

The Company, as part of its strategic focus to operate its retail brokerage business using an independent contractor (IC) model, on January 1, 2003, entered into a Joint Venture Agreement with JSM Capital Holding Corp. ("JSM"), a retail brokerage IC headquartered in New York and founded by John S. Matthews (who was also, at the same time, named the President of vFinance's Retail Brokerage Division). Effective May 1, 2003, vFinance merged its "company-owned" retail branches into JSM, in exchange for a 19% equity position in JSM's common stock. Effective upon such mergers JSM became an IC of the Company.

On November 2, 2004, vFinance, Inc.'s wholly-owned subsidiary, vFinance Investments Holdings, Inc completed its acquisition of certain assets of Global Partners Securities, Inc. ("Global") and 100% of the issued and outstanding equity securities of EquityStation, Inc. ("EquityStation"), all of which were owned by Level2.com, Inc. ("Level2"), a subsidiary of Global. These transactions are subject to the approval of the National Association of Securities Dealers, Inc.

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The assets acquired from Global included certain intellectual property, customer accounts, computer equipment, and certain clearance and trading agreements relating to emerging market debt trading, wholesale market-making in selected equities for institutional clients, and direct-access equity trading. vFinance Investments Holdings assumed no liabilities in connection with the acquisition of Global's assets. Two of the principals of Global and Equity each entered into employment agreements with the Company which provided an annual base salary of \$144,000, certain incentive bonuses, and options to purchase 350,000 shares of the Company's common stock, \$0.01 par value (the "Common Stock"). The options are exercisable at \$0.19 per share, and vest ratably over a three year period.

In accordance with the terms of the acquisition agreements of Global and EquityStation, the Company delivered into escrow 8,324,690 restricted shares (the "Shares") of the Common Stock, and warrants (the "Warrants") to purchase 3,299,728 shares of the Common Stock at a price of \$0.11 per share. All of the shares of EquityStation were also delivered into escrow. Subject to (a) any indemnification claims under the acquisition agreements and (b) the financial performance of EquityStation and the business of Global acquired by vFinance Investments over the periods specified in the escrow agreement, all or a portion of the Shares and the Warrants will be distributed to Global and Level2. As determined pursuant to the financial performance calculation in the escrow agreement, 2,199,425 of the Shares and 871,805 of the Warrants are subject to cancellation in accordance with the terms of the escrow agreement. This is reflected in the purchase price and the associated goodwill recorded as of December 31, 2004. When the escrow agreement is terminated, all of the shares of EquityStation will be distributed to vFinance Investments Holdings, and the holders of the Shares and Warrants will be entitled to certain piggyback registration rights. The Company also entered into a standstill agreement with each of Marcos Konig, Harry Konig and Salomon Konig, to provide restrictions on certain actions for a defined time period.

EquityStation is a broker-dealer registered with the Securities and Exchange Commission ("SEC") and is a member of the National Association of Securities Dealers (NASD). The company is a Florida corporation incorporated on July 22, 1999. EquityStation offers institutional traders, hedge funds, and professional traders a suite of services designed to advance their trading through cutting-edge trading technologies and routing software, hedge fund incubation, capital introduction and custodial services.

OUR COMPANY. We are a diversified financial services company committed to meeting the financial needs of high net-worth investors, institutions focused on portfolio growth and management strategies, and high growth emerging companies seeking capital. The Company's principal activities are provided by four business units: Retail Brokerage offers securities brokerage services including the sale of equities, mutual funds and fixed income products. Investment Banking assists emerging growth private and public companies develop sound strategic plans and access capital. Wholesale Trading operation provides wholesale market-making services for nearly 2000 Over-the-Counter Bulletin Board and NASDAQ Small Cap stocks to national and regional full-service broker-dealers, electronic discount brokers, and institutional investors. Institutional Services provides investment, technology and research services to institutional fund managers and other institutional investors.

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In the execution of our business strategy, the Company has created a Website, [www.vfinance.com](http://www.vfinance.com), that reaches a worldwide audience of individuals looking to

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create wealth through equity investments in both their personal portfolios and their businesses. Our Website is a leading destination for entrepreneurs, owners of small and medium businesses looking for capital, venture capitalists and private (i.e. Angel) and institutional investors seeking equity investments in high growth companies. Each month our Website attracts an estimated 80,000 business owners from over 100 countries and communicates to approximately 60,000 high net-worth individuals and institutional investors. Our Website is typically listed by search engines as one of the top sites for relevant content. In addition, over 5,000 Websites have links to our Website including Microsoft Network, Dow Jones, THE WALL STREET JOURNAL, ENTREPRENEUR MAGAZINE, INC., Stanford University, and Yahoo!. Our business model is scalable as a) the Website provides sales leads to our Retail Brokerage, Investment Banking, and Institutional Services Divisions and b) the firm has structured its Banking and Brokerage business to take advantage of an Independent Contractor model allowing the firm to expand and contract without the costs and liabilities associated with employees and offices. Due to the Website's large, global audience of entrepreneurs and venture investors, the Company uses it to collect, measure and analyze data on entrepreneurial activity. The Company uses its proprietary research to publish reports on the entrepreneurial economy that provide the firm's clients with proprietary insights to investment opportunities.

### RECENT FINANCINGS

The Company entered into two agreements with financial institutions to increase our resources. The discussion below is qualified in its entirety by reference to the copies of the agreements attached as exhibits to this filed report.

On November 28, 2001, we entered into a Note Purchase Agreement, as amended on November 30, December 14, December 28, 2001, February 13 and March 4, 2002 (collectively, the "Agreement"), with SBI Investments (USA) Inc. ("SBI"). Under the terms of the Agreement, SBI provided a loan to us in the amount of \$975,000 in the form of a 48-month non-interest bearing, convertible note (the SBI Note). The SBI Note is convertible at SBI's option into as many as 3,421,052 shares of our common stock at \$0.285 per share. During year 2002, the SBI Note was reduced by \$225,000 as a portion of the SBI Note was converted into 789,474 shares of the Company's common stock. During February and March of 2004, \$721,500 of the SBI Note was converted into 3,344,298 shares of the Company's common stock. Of this amount, \$545,000 was converted into 2,725,000 shares of the Company's common stock at a discounted rate of \$0.20 per share under a special arrangement offered by the Company to encourage further equity participation by SBI, which resulted in a \$231,625 conversion premium expense during the first quarter of 2004. The remainder, \$176,500, was converted into 619,298 shares at the stated conversion rate of \$0.285 per share. In April of 2004, the remaining balance was converted into 100,000 shares of common stock of the Company at the original stated conversion rate of \$.285 per share. The issuance of the common stock was exempt from registration pursuant to Section 4 (2) of the Securities Act of 1933, as amended, because the common stock was acquired in a privately negotiated transaction by sophisticated investors. Accordingly, the balance due SBI at December 31, 2003 was \$750,000 and 2004 was \$0.

On January 25, 2002, the Company entered into a Credit Agreement, as amended on April 12, 2002, with UBS Americas, Inc. ("UBS"). Under the terms of the Credit Agreement, UBS provided the Company with a revolving credit facility for up to \$3,000,000 for the purpose of supporting the expansion of our brokerage business or investments in infrastructure to expand our operations and our broker-dealer operations. The loan had a term of 4 years, was required to be repaid in full by January 2005, and accrued interest at LIBOR plus a LIBOR margin of 2% if the loan was repaid within a month or 5% if it was outstanding more than a month. The Company borrowed \$1,500,000 under the credit facility on January 28, 2002 leaving an additional \$1,500,000 available. In June 2003, Fidelity Investments, on behalf of its clearing division, National Financial Services LLC, Member

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NYSE/SIPC, a Fidelity Investments company ("NFS"), announced that it had acquired Correspondent Services Clearing ("CSC"), an affiliate of UBS and vFinance Investments' clearing firm at the time. The credit facility stayed with UBS subsequent to the acquisition giving rise to potential breaches under such credit facility as well as precluding the Company from drawing an additional \$1,500,000 thereunder. During March 2004, NFS agreed to directly pay down the UBS credit facility in the amount of \$1,500,000 pursuant to a guaranty Fidelity Investments made to UBS as part of their original acquisition of the CSC clearing division. As a result, the Company was relieved from \$1,500,000 in debt but no longer had the ability to obtain an additional \$1,500,000 under the credit facility or assert any claims against UBS or NFS regarding this transaction and credit facility. During March 2004, the Company entered into a clearing agreement with NFS. The new clearing agreement required NFS to pay to vFinance, over a five year period beginning January 2004, a monthly incentive bonus not to exceed \$25,000 per month up to \$1,500,000, based on a formula that the Company believes is very achievable. Accordingly, NFS has been paying \$25,000 per month related to this incentive calculation and such amount, \$300,000 through December 31, 2004, has been included in the attached statements of operations as "other brokerage related income". The new clearing agreement also required NFS to provide the Company with \$200,000 to assist the Company with transition costs related to the conversion from CSC to NFS. This amount was paid to vFinance in March 2004 and was included in the first quarter's statements of operations as a reduction to clearing and transaction costs. In consideration for these incentives, NFS required a termination fee of \$1,700,000 should vFinance discontinue using NFS' services. This fee is reduced, pro rata, annually over the five year term of the agreement. The Company began clearing through NFS during May 2004.

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### OUR BUSINESS

RETAIL AND TRADING BUSINESS. The largest portion of our revenues 85% in 2004 and 82% in 2003 was attributable to commissions generated by our brokerage and trading activities through our wholly owned broker-dealer subsidiary, vFinance Investments. vFinance Investments' Retail Brokerage and Trading Divisions buys and sells securities for its customers from other dealers on an agency basis, and charges its customers a commission for its services. Such commission revenue is derived from brokerage transactions in listed and over-the-counter securities and mutual fund securities. vFinance Investments has agreements with numerous mutual fund management companies pursuant to which it sells shares in a variety of mutual funds. Mutual fund commissions are derived from standard dealers' discounts that are a small percentage of the purchase price of the shares depending upon the terms of the dealer agreement and the size of the transaction. In addition, most funds permit vFinance Investments to receive additional periodic fees based upon the customer's investments maintained in particular funds.

INVESTMENT BANKING. A significant portion of our revenues in our last fiscal year were derived from the success fees generated by our vFinance Investments' Investment Banking Division (12% in 2004) (14% in 2003). We assist emerging growth private and public companies by (i) developing sound strategic plans, (ii) obtaining equity, mezzanine, bridge, or acquisition capital, (iii) executing strategically sound acquisitions or divestiture strategies, (iv) raising capital in the public markets, and (v) maximizing shareholder value by conducting recapitalizations or other liquidity transactions. As consideration for such services, we are paid retainers and success fees, based on the percentage of the total value of a transaction, which are contingent on the successful completion of a specified transaction. As part of our success fees, we periodically receive equity instruments and stock purchase warrants from



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companies for which we perform services in addition to cash paid for such services.

In the area of corporate finance, vFinance Investments has been active as underwriters or selling group members in numerous public equity transactions. Participation as a managing underwriter or in an underwriting syndicate involves both economic and regulatory risks. An underwriter may incur losses if it is unable to resell the securities it is committed to purchase. In addition, under the federal securities laws, other laws and court decisions with respect to underwriters' liabilities and limitations on the indemnification of underwriters by issuers, an underwriter is subject to substantial potential liability for misstatements or omissions of material facts in prospectuses and other communications with respect to such offerings. Acting as a managing underwriter increases these risks. Underwriting commitments constitute a charge against net capital and our subsidiaries' ability to make underwriting commitments may be limited by the requirement that they must at all times be in compliance with regulations regarding their net capital.

WHOLESALE TRADING BUSINESS. In support of the firm's retail brokerage, banking and institutional services businesses, we offer wholesale market-making services. vFinance Investments makes markets in nearly 2000 Over-the-Counter Bulletin Board and NASDAQ Small Cap stocks. The Company's customers are national and regional full-service broker-dealers, electronic discount brokers and institutional investors that require fast and efficient executions for each security. This expertise supports the firm's investment banking strategy of servicing high growth public companies that are looking for a financial services firm that is capable of assisting them in building broad-based market support for their securities. Market makers use the firm's capital, research, retail and systems resources to represent a stock and compete with other market makers. Operated primarily by electronic execution, buyers and sellers meet via computer to make bids and offers. Each market maker competes for "customer order flow" by displaying buy and sell quotations for a guaranteed number of shares in a security. Once an order is received, the market maker will immediately purchase for or sell from its own inventory, or seek the other side of the trade until it is executed, often in a matter of seconds. The market maker generates all of its revenue from the difference between the price paid when a security is bought and price received when that security is sold or the price received when the security is shorted and the price received when the short is covered.

INSTITUTIONAL SERVICES. A critical element of the Company's business strategy is to identify institutional quality investments that offer high returns. The Institutional Services Division ("ISD") supports that mission by providing institutional investment managers, primarily hedge fund managers, a complete array of services designed to enhance portfolio performance. Hedge funds represent the fastest growing segment of the money management market and by definition are focused on achieving positive returns for their investors while controlling risk. ISD accomplishes its mission by offering fund managers access to investment opportunities and independent research products that boost return on investment. Additionally, we offer fund managers the ability to reduce their transaction costs by offering them access to our trading desk for illiquid securities and automated trading systems for their liquid transactions. ISD has a mutually beneficial relationship with the Company's Investment Banking Division ("IBD") as fund managers looking for investment opportunities fund IBD's corporate clients and having relationships with fund managers creates opportunities to increase the number and quality of IBD clients.

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INTERNET STRATEGY ([www.vfinance.com](http://www.vfinance.com)). vFinance Holdings, Inc., operates a financial services Website or "channel" on the World Wide Web located at

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<http://www.vfinance.com>. With an estimated 3.4 million visitors annually, the Website reaches a global audience of entrepreneurs, CEOs, and private and institutional investors in over 150 countries. The Website provides sales leads to our investment banking, brokerage and institutional services divisions. The Website is the premier destination for search phrase "venture capital" and "raising capital". Website visitors have convenient access to a variety of financial services, proprietary business development tools, searchable databases, and daily news. The website has over 80,000 "opted in" subscribers that receive a daily newsletter on private funding. The Website features our database of venture capital firms and angel investors accessible with vSearch, our proprietary Web-based data mining tool that allows entrepreneurs to search potential funding sources by different criteria, including, geography, amount of funds required, industry, stage of corporate development, or keyword. Much of the information on the website is provided free of charge, however, we do charge nominal fees for the use of proprietary search engines and premium services such as our business planning services.

### ADMINISTRATION, OPERATIONS, SECURITIES TRANSACTIONS PROCESSING AND CUSTOMER ACCOUNTS

Our operating subsidiaries, vFinance Investments and EquityStation, do not hold any funds or securities for customers. Instead, they use the services of clearing agents on a fully disclosed basis. These clearing agents process all securities transactions and maintain customer accounts on a fee basis. Customer accounts are protected through the SIPC for up to \$500,000, of which coverage for cash balances is limited to \$100,000. In addition, all customer accounts of vFinance Investments are fully protected by an Excess Securities Bond providing protection for the account's entire net equity (both cash and securities). The services of our subsidiaries' clearing agents include billing and credit control as well as receipt, custody and delivery of securities. The clearing agents provide the operational support necessary to process, record, and maintain securities transactions for our subsidiary's brokerage activities. They provide these services to our subsidiary's customers at a total cost which we believe is less than it would cost us to process such transactions on our own. The clearing agents also lend funds to our subsidiaries' customers through the use of margin credit. These loans are made to customers on a secured basis, with the clearing agents maintaining collateral in the form of saleable securities, cash or cash equivalents. vFinance Investments and Equity Station have agreed to indemnify the clearing brokers for losses they incur on these credit arrangements.

### COMPETITION

vFinance Investments and EquityStation, our subsidiaries, encounter competition in all aspects of their business. Many of their competitors have significantly greater financial, technical, marketing and other resources. National retail firms such as Merrill Lynch Pierce Fenner & Smith Incorporated, Salomon Smith Barney, Inc. and Morgan Stanley/Dean Witter dominate the industry. Our subsidiaries also compete with numerous regional and local firms. In addition, a number of firms offer discount brokerage services to retail customers and generally effect transactions at substantially lower commission rates on an "execution only" basis, without offering other services such as investment recommendations and research. Moreover, there is substantial commission discounting by full-service broker-dealers competing for institutional and retail brokerage business. The emergence of online trading has further intensified the competition for brokerage customers. With the exception of offering certain trading platforms to institutional clients and portfolio managers, our subsidiaries do not offer online trading services to retail customers. The continued expansion of discount brokerage firms and online trading could adversely affect our retail business. Other financial institutions, notably commercial banks and savings and loan associations, offer

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customers some of the same services and products presently provided by securities firms. While it is not possible to predict the type and extent of competing services which banks and other institutions ultimately may offer to customers, our subsidiaries may be adversely affected to the extent those services are offered on a large-scale basis. We compete through our advertising and recruiting programs for registered representatives interested in potentially joining our Company.

### GOVERNMENT REGULATION

REGULATION OF THE SECURITIES INDUSTRY AND BROKER-DEALERS. Our business is subject to extensive regulation applicable to the securities industry in the United States and elsewhere. As a matter of public policy, regulatory bodies in the United States and the rest of the world are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. In the United States, the SEC is the federal agency responsible for the administration of the federal securities laws. In general, broker-dealers are required to register with the SEC under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Under the Exchange Act, every registered broker-dealer that does business with the public is required to be a member of and is subject to the rules of the NASD. The NASD administers qualification testing for all securities principals and registered representatives for its own account and on behalf of the state securities authorities. vFinance Investments and EquityStation are broker-dealers registered with the SEC and members of the NASD.

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Our broker-dealers are also subject to regulation under state law. vFinance Investments and EquityStation are currently registered as broker-dealers in all 50 states and the District of Columbia. The NASD approved the change of ownership to us of (i) Union Atlantic Capital, L.C. from Pinnacle Capital Group, L.C., (ii) First Level Capital, Inc. from NW Holdings, Inc. and (iii) First Colonial Securities Group, Inc. A recent amendment to the federal securities laws prohibits the states from imposing substantive requirements on broker-dealers that exceed those imposed under federal law. The amendment, however, does not preclude the states from imposing registration requirements on broker-dealers that operate within their jurisdiction or from sanctioning these broker-dealers who have engaged in misconduct.

The SEC, self-regulatory organizations such as the NASD and state securities commissions may conduct administrative proceedings which can result in censure, fine, the issuance of cease-and-desist orders, or the suspension or expulsion of a broker-dealer, its officers, or its employees. The SEC and self-regulatory organization rules cover many aspects of a broker-dealer's business, including capital structure and withdrawals, sales methods, trade practices among broker-dealers, use, and safekeeping of customers' funds and securities, record-keeping, the financing of customers' purchases, broker-dealer and employee registration, and the conduct of directors, officers, and employees. Additional legislation, changes in rules promulgated by the Commission and self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules, may directly affect the mode of operation and profitability of broker-dealers.

The Uniform Net Capital Rule and NASD rules require prior notice to the SEC and the NASD for certain withdrawals of capital and also provide that the SEC may restrict for up to 20 business days any withdrawal of equity capital, or unsecured loans or advances to shareholders, employees or affiliates if the capital withdrawal, together with all other net capital withdrawals during a

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30-day period, exceeds 30% of excess net capital and the SEC concludes that the capital withdrawal may be detrimental to the financial integrity of the broker-dealer.

In addition, the Uniform Net Capital Rule provides that the total outstanding principal amount of a broker-dealer's indebtedness under certain subordination agreements, the proceeds of which are included in its net capital, may not exceed 70% of the sum of the outstanding principal amount of all subordinated indebtedness included in net capital, par or stated value of capital stock, paid in capital in excess of par, retained earnings and other capital accounts for a period in excess of 90 days. A change in the Uniform Net Capital Rule, the imposition of new rules or any unusually large charge against net capital could limit those parts of our operations that require the intensive use of capital and also could restrict our ability to pay dividends, repay debt and repurchase shares of our outstanding stock.

As of December 31, 2004, the minimum amount of net capital required to be maintained by vFinance Investments was \$1,000,000 and the minimum amount of net capital required to be maintained by our wholly owned subsidiary, EquityStation was \$100,000. A significant operating loss or any unusually large charge against net capital could adversely affect our ability to expand or even maintain our present levels of business, which could have a material adverse affect on our business and operations. vFinance Investments and EquityStation are members of Securities Investor Protection Corporation ("SIPC") which provides, in the event of the liquidation of a broker-dealer, protection for clients' accounts up to \$500,000, subject to a limitation of \$100,000 for claims for cash balances. vFinance Investments clients' accounts are carried on the books and records of NFS and Jefferies. NFS has obtained additional insurance from a private insurer in an amount equal to \$4,500,000 for the benefit of our clients' accounts with vFinance Investments that is supplemental to SIPC protection. The client accounts for Equity Station are carried on the books and records of Merrill Lynch, Pierce, Fenner & Smith ("Merrill Lynch").

### APPLICATION OF LAWS AND RULES TO INTERNET BUSINESS AND OTHER ONLINE SERVICES.

Due to the increasing popularity and use of the Internet and other online services, various regulatory authorities are considering laws and/or regulations with respect to the Internet or other online services covering issues such as user privacy, pricing, content copyrights, and quality of services. In addition, the growth and development of the market for online commerce may prompt more stringent consumer protection laws that may impose additional burdens on those companies conducting business online. When the Securities Act of 1933, as amended (the "Securities Act"), which governs the offer and sale of securities, and the Exchange Act, which governs, among other things, the operation of the securities markets and broker-dealers, were enacted, such acts did not contemplate the conduct of a securities business through the Internet and other online services. The recent increase in the number of complaints by online traders could lead to more stringent regulations of online trading firms and their practices by the SEC, NASD and other regulatory agencies.

Although the SEC, in releases and no-action letters, has provided guidance on various issues related to the offer and sale of securities and the conduct of a securities business through the Internet, the application of the laws to the conduct of a securities business through the Internet continues to evolve.

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Furthermore, the applicability to the Internet and other online services of existing laws in various jurisdictions governing issues such as property ownership, sales and other taxes and personal privacy is uncertain and may take years to resolve. Uncertainty regarding these issues may adversely affect the viability and profitability of our business.

As our services, through our subsidiaries, are available over the Internet in multiple jurisdictions, and as we, through our subsidiaries, have numerous clients residing in these jurisdictions, these jurisdictions may claim that our subsidiaries are required to qualify to do business as a foreign corporation in each such jurisdiction. While vFinance Investments and EquityStation are currently registered as broker-dealers in the jurisdictions described in this report, vFinance Investments, EquityStation and our non-broker dealer subsidiaries are qualified to do business as a foreign corporation in only a few jurisdictions. Failure to qualify as an out-of-state or foreign corporation in a jurisdiction where it is required to do so could subject us to taxes and penalties for the failure to qualify.

### INTELLECTUAL PROPERTY

We own the following federally registered marks: vFinance, Inc.(R), vFinance.com, Inc.(R), AngelSearch(R).

### EMPLOYEES

At December 31, 2004, we employed the following personnel:

| Position           | Salaried | Contract | Total |
|--------------------|----------|----------|-------|
| Officers           | 7        | 0        | 7     |
| Administration     | 16       | 5        | 21    |
| Brokers            | 6        | 128      | 134   |
| Traders            | 17       | 4        | 21    |
| Investment Bankers | 10       | 4        | 14    |
| Web Operations     | 2        | 0        | 2     |
| Totals             | 58       | 141      | 199   |

None of our personnel is covered by a collective bargaining agreement. We consider our relationships with our employees to be good. Any future increase in the number of employees will depend upon the growth of our business. Our registered representatives are required to take examinations administered by the NASD and state authorities in order to qualify to transact business and are required to enter into agreements with us obligating them, among other things, to adhere to industry rules and regulations, our supervisory procedures and not to solicit customers in the event of termination of employment.

### RESEARCH AND DEVELOPMENT AND ENVIRONMENTAL MATTERS

We did not incur any research and development expenses. We do not incur any significant costs or experience any significant effects as a result of compliance with federal, state and local environmental laws.

### RISKS RELATED TO OUR COMPANY

In addition to other information in this report, the following risks should be considered in evaluating our condition and prospects. These risks may have a material effect on our operating results.

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WE HAVE A LIMITED OPERATING HISTORY. AS A RESULT, IT MAY BE DIFFICULT EVALUATING OUR BUSINESS AND PROSPECTS.

We have a limited operating history. We only commenced our broker-dealer operations in the middle of 2000. In addition, we completely restructured our broker-dealer operations in 2001 through the acquisition of two firms and their merger into a single operation. We purchased our hedge fund management business in mid-2001, but we decided to liquidate such funds. Our website has been in existence since 1995. In 2004, we acquired a second broker-dealer, EquityStation, which has been in operation since mid 1999. Our business and prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in the early stages of development. These risks are particularly severe among companies in new and rapidly evolving markets such as online business development services and those in regulated industries such as the securities industry. It may be difficult or impossible to accurately forecast our operating results and to evaluate our business and prospects based on our historical results.

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WE HAVE HAD SUBSTANTIAL LOSSES SINCE INCEPTION

Prior to 2003, the Company had sustained substantial losses in each year since its inception due to ongoing operating expenses and a lack of revenues sufficient to offset those operating expenses. We have raised capital to fund ongoing operations by private sales of our securities, some of which sales have been highly dilutive and involved considerable expense. Although we had net income of \$2,774,435 for the year ended December 31, 2004 and net income of \$311,415 for the year ended December 31, 2003, we incurred a net loss of \$2,235,298 for the year ended December 31, 2002 and prior years had even larger net losses. The profit generated in 2004, was largely the result of debt forgiveness on our \$1.5 million dollar loan which is non-recurring. As of December 31, 2004, we had an accumulated deficit of \$20,815,806. We expect to spend significant amounts to enhance our products and technologies, and to expand domestic and international sales and operations. As a result, we will need to continue to generate significant additional revenue to maintain our recent profitability and generate sufficient working capital to fund our planned spending. Even if we do maintain profitability, we may not be able to increase profitability on a quarterly or annual basis. If we do not increase our profitability, the market price for our common stock may further decline.

Obtaining future financing may be costly and could be dilutive to existing stockholders. If we are not able to obtain financing when and in the amounts needed, and on terms that are acceptable, our operations, financial condition and prospects could be materially adversely affected, and we could be forced to curtail our operations or sell part or all of our assets.

WE MAY NEED TO RAISE ADDITIONAL FUNDS. THESE FUNDS MAY NOT BE AVAILABLE WHEN WE NEED THEM.

Based on our current spending plans and our projected working capital, we believe that our cash on hand and cash generated from our operations will be sufficient to fund our operations for at least the next 12 months. However, the Company may attempt to raise additional capital to operate the business, support expansion plans, develop new or enhanced services and products, respond to competitive pressures, acquire complementary businesses or technologies or respond to unanticipated events. We can provide no assurances that additional financing will be available when needed on favorable terms, if at all. If these

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funds are not available when we need them, we may need to change our business strategy or reduce our operations or investment activities. In addition, any issuance of additional equity securities will dilute the ownership interest of our existing stockholders and the issuance of additional debt securities may increase the perceived risk of investing in us.

WE ARE SUBJECT TO VARIOUS RISKS ASSOCIATED WITH THE SECURITIES INDUSTRY.

As securities broker-dealers, we are subject to uncertainties that are common in the securities industry. These uncertainties include:

- the volatility of domestic and international financial, bond and stock markets, as demonstrated by past disruptions in the financial markets;
- extensive governmental regulation;
- litigation;
- intense competition;
- substantial fluctuations in the volume and price level of securities; and
- dependence on the solvency of various third parties.

As a result of these risks, revenues and earnings may vary significantly from quarter to quarter and from year to year. We are much smaller and have much less capital than many of our competitors in the securities industry. Accordingly, we could be impacted by these risks to a larger degree. In the event of a market downturn our revenues would likely decline and, if we were unable to reduce expenses at the same pace, our profit margins would quickly erode. Our business could be adversely affected in many other ways, including those described below.

OUR BUSINESS COULD BE ADVERSELY AFFECTED BY A BREAKDOWN IN THE FINANCIAL MARKETS

As a securities broker-dealer, our business is materially affected by conditions in the financial markets and economic conditions in general, both in the United States and elsewhere around the world. Many factors or events could lead to a breakdown in the financial markets including war, terrorism, natural catastrophes and other types of disasters. These types of events could cause people to begin to lose confidence in the financial markets and their ability to function effectively. If the financial markets are unable to effectively prepare for these types of events and ease public concern over their ability to function, our revenues may decline and our operations could be adversely affected.

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WE HAVE INCURRED, AND MAY IN THE FUTURE INCUR, SIGNIFICANT LOSSES FROM TRADING AND INVESTMENT ACTIVITIES DUE TO MARKET FLUCTUATIONS AND VOLATILITY.

We generally maintain trading and investment positions in the equity markets. To the extent that we own assets, i.e.: have long positions, a downturn in those markets could result in losses from a decline in the value of such long positions. Conversely, to the extent that we have sold assets that we do not own, i.e.: have short positions in any of those markets, an upturn could expose us to potentially unlimited losses as we attempt to cover our short positions by acquiring assets in a rising market.

We may, from time to time, have a trading strategy consisting of holding a long position in one asset and a short position in another from which we expect to earn revenues based on changes in the relative value of the two assets. If, however, the relative value of the two assets changes in a direction or manner that we did not anticipate or against which we are not hedged, we might realize

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a loss in those paired positions. In addition, we maintain trading positions that can be adversely affected by the level of volatility in the financial markets, i.e., the degree to which trading prices fluctuate over a particular period, in a particular market, regardless of market levels.

OUR REVENUES MAY DECLINE IN ADVERSE MARKET OR ECONOMIC CONDITIONS.

Unfavorable financial or economic conditions may reduce the number and size of the transactions in which we provide underwriting services, merger and acquisition consulting and other services. Our investment banking revenues, in the form of financial advisory and underwriting fees, are directly related to the number and size of the transactions in which we participate and would therefore be adversely affected by a sustained market downturn. Additionally, a downturn in market conditions could lead to a decline in the volume of transactions that we execute for our customers and, therefore, to a decline in the revenues we receive from commissions and spreads.

OUR RISK MANAGEMENT POLICIES AND PROCEDURES MAY LEAVE US EXPOSED TO UNIDENTIFIED RISKS OR AN UNANTICIPATED LEVEL OF RISK.

The policies and procedures we employ to identify, monitor and manage risks may not be fully effective. Some methods of risk management are based on the use of observed historical market behavior. As a result, these methods may not accurately predict future risk exposures, which could be significantly greater than the historical measures indicate. Other risk management methods depend on evaluation of information regarding markets, clients or other matters that are publicly available or otherwise accessible by us. This information may not be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risks requires, among other things, policies and procedures to properly record and verify a large number of transactions and events. We cannot assure that our policies and procedures will effectively and accurately record and verify this information.

We seek to monitor and control our risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems. We believe that we are able to evaluate and manage the market, credit and other risks to which we are exposed. Nonetheless, our ability to manage risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have a material adverse effect on our results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in earnings, increases in our credit risk to customers as well as to third parties and increases in general systemic risk.

CREDIT RISK EXPOSES US TO LOSSES CAUSED BY FINANCIAL OR OTHER PROBLEMS EXPERIENCED BY THIRD PARTIES.

We are exposed to the risk that third parties which owe us money, securities or other assets will not perform their obligations. These parties include:

- trading counterparties;
- customers;
- clearing agents;
- exchanges;
- clearing houses; and
- other financial intermediaries as well as issuers whose securities we hold.



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These parties may default on their obligations owed to us due to bankruptcy, lack of liquidity, operational failure or other reasons. This risk may arise, for example, from:

- holding securities of third parties;
- executing securities trades that fail to settle at the required time due to non-delivery by the counterparty or systems failure by clearing agents, exchanges, clearing houses or other financial intermediaries; and
- extending credit to clients through bridge or margin loans or other arrangements.

Significant failures by third parties to perform their obligations owed to us could adversely affect our revenues and perhaps our ability to borrow in the credit markets.

### WE MAY HAVE DIFFICULTY RETAINING OR RECRUITING OUR INDEPENDENT CONTRACTORS

vFinance Investments is dependent upon the independent contractor model for our retail brokerage business. As such, approximately 90% of our retail registered representatives are independent contractors. We are exposed to the risk that a large group of independent contractors leave the firm or decide to affiliate with another firm and that we are unable to recruit suitable replacements. A loss of a large group of our independent contractors could have a material adverse impact on our ability to generate revenue in the retail brokerage business.

### WE MAY HAVE DIFFICULTY EFFECTIVELY MANAGING OUR GROWTH.

Over the past several years, we have experienced significant growth in our business activities through a variety of transactions. We expect our business to continue to grow through similar transactions as well as organically. Future growth through mergers, acquisitions and other such transactions involves numerous risks such as:

- difficulties and expenses incurred in connection with the subsequent assimilation of the operations and services or products of the acquired company;
- the potential loss of key employees of the acquired company; and
- the diversion of management's attention from other business concerns.

If we are unable to effectively address these risks, we may be required to restructure the acquired business or write off the value of some or all of the assets of the acquired business. Further, this type of growth requires increased investments in management personnel, financial and management systems and controls as well as facilities. We cannot assure that we will experience parallel growth in these areas. If these areas do not grow at the same time, our operating margins may decline from current levels.

Additionally, as is common in the securities industry, we will continue to be highly dependent on the effective and reliable operation of our communications and information systems. We believe that our current and anticipated future growth will require implementation of new and enhanced communications and information systems and training of our personnel to operate such systems. Any difficulty or significant delay in the implementation or operation of existing or new systems or the training of personnel could adversely affect our ability to manage our growth.

### INTENSE COMPETITION FROM EXISTING AND NEW ENTITIES MAY ADVERSELY AFFECT OUR REVENUES AND PROFITABILITY.

The securities industry is rapidly evolving, intensely competitive and has few

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barriers to entry. We expect competition to continue to intensify in the future. Many of our competitors have significantly greater financial, technical, marketing and other resources than we do. They may also offer a wider range of services and financial products than we do and have greater name recognition and a larger client base. These competitors may be able to respond more quickly to new or changing opportunities, technologies and client requirements. They may also be able to undertake more extensive promotional activities, offer more attractive terms to clients, and adopt more aggressive pricing policies. We may not be able to compete effectively with current or future competitors and competitive pressures faced by us may harm our business.

THE PRECAUTIONS WE TAKE TO PREVENT AND DETECT EMPLOYEE MISCONDUCT MAY NOT BE EFFECTIVE AND WE COULD BE EXPOSED TO UNKNOWN AND UNMANAGED RISKS OR LOSSES.

We run the risk that employee misconduct could occur. Misconduct by employees could include:

- employees binding us to transactions that exceed authorized limits or present unacceptable risks to us;
- employees hiding unauthorized or unsuccessful activities from us; or
- the improper use of confidential information.

These types of misconduct could result in unknown and unmanaged risks or losses to us including regulatory sanctions and serious harm to our reputation. The precautions we take to prevent and detect these activities may not be effective. If employee misconduct does occur, our business operations could be materially adversely affected.

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### RISK OF LOSSES ASSOCIATED WITH SECURITIES LAWS VIOLATIONS AND LITIGATION.

Many aspects of our business involve substantial risks of liability. An underwriter is exposed to substantial liability under federal and state securities laws, other federal and state laws, and court decisions, including decisions with respect to underwriters' liability and limitations on indemnification of underwriters by issuers. For example, a firm that acts as an underwriter may be held liable for material misstatements or omissions of fact in a prospectus used in connection with the securities being offered or for statements made by its securities analysts or other personnel. In recent years, there has been an increasing incidence of litigation involving the securities industry, including class actions that seek substantial damages. Our underwriting activities will usually involve offerings of the securities of smaller companies, which often involve a higher degree of risk and are more volatile than the securities of more established companies. In comparison with more established companies, smaller companies are also more likely to be the subject of securities class actions, not to carry directors and officer's liability insurance or policies with lower limits, and to become insolvent. Each of these factors increases the likelihood that an underwriter of smaller companies' securities will be required to contribute to an adverse judgment or settlement of a securities lawsuit.

In the normal course of business, our operating subsidiaries have been and continue to be the subject of numerous civil actions and arbitrations arising out of customer complaints relating to our activities as a broker-dealer and as a result of other business activities. In general, the cases involve various allegations that our employees had mishandled customer accounts. We believe that, based on our historical experience and the reserves established by us, the resolution of the claims presently pending will not have a material adverse effect on our financial condition. However, although we typically reserve an

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amount we believe will be sufficient to cover any damages assessed against us, we have in the past been assessed damages that exceeded our reserves. If we misjudged the amount of damages that may be assessed against us from pending or threatened claims or if we are unable to adequately estimate the amount of damages that will be assessed against us from claims that arise in the future and fail to appropriately reserve, our financial condition may be materially adversely affected.

OUR DIRECTORS AND EXECUTIVE OFFICERS CONTROL APPROXIMATELY 30% OF OUR COMMON STOCK AND MAY HAVE INTERESTS DIFFERING FROM THOSE OF OTHER STOCKHOLDERS.

At December 31, 2004, our directors and executive officers controlled approximately 30% of our outstanding common stock, directly as stockholders and indirectly through control relationships with other stockholders. There is no supermajority vote in our Certificate of Incorporation. These directors and executive officers, if acting together, would be able to significantly influence all matters requiring approval by our stockholders, including the election of directors and approval of significant corporate transactions including mergers, consolidations and the sale of substantially all of our assets. This control could have the effect of delaying or preventing a third party from acquiring or merging with us, which could hinder shareholders' ability to receive a premium for their shares.

OUR VFINANCE BRAND MAY NOT ACHIEVE THE BROAD RECOGNITION NECESSARY TO SUCCEED.

We believe that broader recognition and positive perception of the "vFinance" brand is essential to our future success. Accordingly, we intend to continue to pursue an aggressive brand enhancement strategy, which will include multimedia advertising, promotional programs and public relations activities. These initiatives will require significant expenditures. If our brand enhancement strategy is unsuccessful, these expenses may never be recovered and we may be unable to increase future revenues. Successful positioning of our brand will depend in a large part on:

- The success of our advertising and promotional efforts;
- An increase in the number of users and page views of our website; and
- The ability to continue to provide a website and services useful to our clients.

FAILURE TO MAINTAIN OR INCREASE THE FLOW OF TRAFFIC TO OUR WEBSITE COULD HARM OUR BUSINESS.

Our business partially depends on our ability to maintain or increase traffic on our website as well as our ability to have visitors to our website use our services. The website is dependent on the flow of information for its validity, lead generation and data. It is important for our business development activities to increase the number of daily visitors, repeat visitors and the amount of time visitors spend on our website. Failure to do so could adversely affect our revenue and our ability to raise additional funds.

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IF WE DO NOT CONTINUE TO DEVELOP AND ENHANCE OUR SERVICES IN A TIMELY MANNER, OUR BUSINESS MAY BE HARMED.

Our future success will depend on our ability to develop and enhance our services and add new services. We operate in a very competitive industry in which the ability to develop and deliver advanced services through the Internet and other channels is a key competitive factor. There are significant risks in

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the development of new or enhanced services, including the risks that we will be unable to:

- Effectively use new technologies;
- Adapt our services to emerging industry or regulatory standards; or
- Market new or enhanced services.

If we are unable to develop and introduce new or enhanced services quickly enough to respond to market or customer requirements or to comply with emerging industry standards, or if these services do not achieve market acceptance, our business could be seriously harmed.

INTERNET AND INTERNAL COMPUTER SYSTEM FAILURES OR COMPROMISES OF OUR SYSTEMS OR SECURITY COULD DAMAGE OUR REPUTATION AND HARM OUR BUSINESS.

Although a significant portion of our business is conducted using traditional methods of contact and communications such as face-to-face meetings, a portion of our business is conducted through the Internet. We could experience future system failures and degradations. We cannot assure you that we will be able to prevent an extended systems failure if any of the following events occur:

- Human error;
- Subsystem, component, or software failure;
- A power or telecommunications failure;
- An earthquake, fire, or other natural disaster or other act of God;
- Hacker attacks or other intentional acts of vandalism; or
- Terrorists acts or war.

Any such systems failure that interrupts our operations could seriously harm our business. We currently have limited off-site data storage and disaster recovery systems.

The secure transmission of confidential information over public networks is a critical element of our operations. We rely on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information over the Internet. To the best of our knowledge, to date, we have not experienced any security breaches in the transmission of confidential information. Moreover, we continually evaluate advanced encryption technology to ensure the continued integrity of our systems. However, we cannot assure that advances in computer capabilities, new discoveries in the field of cryptography or other events or developments will not result in a compromise of the technology or other algorithms used by our vendors and us to protect client transaction and other data. Any compromise of our systems or security could harm our business.

THERE ARE RISKS ASSOCIATED WITH OUR STOCK TRADING ON THE NASD OTC BULLETIN BOARD RATHER THAN A NATIONAL EXCHANGE.

There are significant consequences associated with our stock trading on the NASD OTC Bulletin Board rather than a national exchange. The effects of not being able to list our securities on a national exchange include:

- Limited release of the market prices of our securities;
- Limited news coverage;
- Limited interest by investors in our securities;
- Volatility of our stock price due to low trading volume;
- Increased difficulty in selling our securities in certain states due to "blue sky" restrictions; and
- Limited ability to issue additional securities or to secure additional financing.

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IF OUR COMMON STOCK IS SUBJECT TO PENNY STOCK RULES, A STOCKHOLDER MAY HAVE GREATER DIFFICULTY SELLING SHARES.

The Securities Enforcement and Penny Stock Reform Act of 1990 applies to stocks characterized as "penny stocks," and requires additional disclosure relating to the market for penny stocks in connection with trades in any stock defined as a penny stock. The Securities and Exchange Commission has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions.

The exceptions include exchange-listed equity securities and any equity security issued by an issuer that has:

- net tangible assets of at least \$2,000,000, if the issuer has been in continuous operation for at least three years;
- net tangible assets of at least \$5,000,000, if the issuer has been in continuous operation for less than three years;
- or - average annual revenue of at least \$6,000,000 for the last three years.

Unless an exception is available, the regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks.

If our financial condition does not meet the above tests, then trading in the common stock will be covered by Rules 15c-1 through 15c-6 and 15c-9 promulgated under the Securities Exchange Act. Under those rules, broker-dealers who recommend such securities to persons other than their established customers and institutional accredited investors must make a special written suitability determination for the purchaser and must have received the purchaser's written agreement to a transaction prior to sale. These regulations would likely limit the ability of broker-dealers to trade in our common stock and thus would make it more difficult for purchasers of common stock to sell their securities in the secondary market. The market liquidity for the common stock could be severely affected.

WE DEPEND ON A LIMITED NUMBER OF KEY EXECUTIVES WHO WOULD BE DIFFICULT TO REPLACE.

Our success depends significantly on the continued services of our senior management, especially Leonard J. Sokolow, our Chief Executive Officer and President. Losing Mr. Sokolow or any of our and our subsidiaries' other key executives, including Timothy E. Mahoney, our Chairman and Chief Operating Officer, could seriously harm our business. We cannot assure you that we will be able to retain our key executives or that we would be able to replace any of our key executives if we were to lose their services for any reason. Competition for these executives is intense. If we had to replace any of these key executives, we would not be able to replace the significant amount of knowledge that these key executives have about our operations. We do not maintain "key person" insurance policies on any of our executives.

OUR OPERATING BROKER-DEALER SUBSIDIARIES EXTEND CREDIT TO THEIR CLIENTS AND ARE SUBJECT TO RISKS AS A RESULT.

Our broker dealers, vFinance Investments and EquityStation clear all transactions for customers on a fully disclosed basis with their clearing brokers, NFS, Jefferies and Merrill Lynch, respectively. These clearing brokers carry and clear all customer securities accounts. A limited portion of the customer securities activities for both broker dealers are transacted on a "margin" basis, pursuant to which credit is extended to customers, which (a) is

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secured by cash and securities in customer accounts, or (b) involve (i) "short sales" (i.e., the sale of securities not yet purchased) or (ii) the purchase and sale of commodity futures contracts, substantially all of which are transacted on a margin basis. These risks are increased during periods of volatile markets in which the value of the collateral held could fall below the amount borrowed by clients. If margin requirements are not sufficient to cover losses, the broker dealers may be required to sell or buy securities at prevailing market prices and incur losses to satisfy its client obligations.

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WE MAY UNDERWRITE SECURITIES THROUGH VFINANCE INVESTMENTS AND ARE SUBJECT TO LOSSES RELATING TO A DECLINE IN THE MARKET VALUE OF SECURITIES THAT WE HOLD IN INVENTORY AND TO POTENTIAL LIABILITY FOR ENGAGING IN UNDERWRITING ACTIVITIES.

The underwriting activities of vFinance Investments involve the purchase, sale or short sale of securities as a principal. As an underwriter, vFinance Investments agrees to purchase securities on a "firm commitment" basis and is subject to risk that it may be unable to resell securities or be required to dispose of securities at a loss. In connection with our investment-banking activities in which vFinance Investments acts as a manager or co-manager of public offerings of securities, we expect to make increased commitments through vFinance Investments of capital to market making activities in securities of those issuers. Any additional concentration of capital in the securities of those issuers held in inventory will increase the risk of loss from possible declines in the market price of those securities. In addition, under federal securities laws, other laws and court decisions with respect to underwriters' liabilities and limitations on the indemnification of underwriters by issuers, an underwriter is subject to substantial potential liability for misstatements or omissions of material facts in prospectuses and other communications with respect to securities offerings. Our potential liability through vFinance Investments as an underwriter is generally not covered by insurance. Moreover, underwriting commitments constitute a charge against net capital and the ability of vFinance Investments to make underwriting commitments may be limited by the requirement that it must at all times be in compliance with the net capital rule.

OUR SUCCESS AND ABILITY TO COMPETE DEPEND TO A SIGNIFICANT DEGREE ON OUR INTELLECTUAL PROPERTY

We rely on copyright and trademark law, as well as confidentiality arrangements, to protect our intellectual property. The Company owns the following federally registered marks: vFinance, Inc.(R), vFinance.com, Inc.(R), and AngelSearch(R). We currently do not have any patents. The concepts and technologies we use may not be patentable. Our competitors or others may adopt product or service names similar to "vFinance.com," thereby impeding our ability to build brand identity and possibly leading to client confusion. Our inability to adequately protect the name "vFinance.com" would seriously harm our business. Policing unauthorized use of our intellectual property is made especially difficult by the global nature of the Internet and the inherent difficulty in controlling the ultimate destination or security of software or other data transmitted on it.

The laws of other countries may afford us little or no effective protection for our intellectual property. We cannot assure you that the steps we take will prevent misappropriation of our intellectual property or that agreements entered into for that purpose will be enforceable. In addition, litigation may be necessary in the future to:

- Enforce our intellectual property rights;
- Determine the validity and scope of the proprietary rights of others; or

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- Defend against claims of infringement or invalidity.

Such litigation, whether successful or unsuccessful, could result in substantial costs and diversions of resources, either of which could seriously harm our business.

OUR BOARD OF DIRECTORS CAN ISSUE SHARES OF "BLANK CHECK" PREFERRED STOCK WITHOUT FURTHER ACTION BY OUR STOCKHOLDERS.

Our Board of Directors has the authority, without further action by the stockholders, to issue up to 2,500,000 shares of preferred stock in one or more series and to fix the rights, preferences, privileges and restrictions in each series of the preferred stock, including:

- Dividend rights;
- Conversion rights;
- Voting rights, which may be greater or lesser than the voting rights of the common stock;
- Rights and terms of redemption;
- Liquidation preferences; and
- Sinking fund terms.

In connection with the merger with Colonial Direct Financial Group, Inc., the Company issued 122,500 shares of Series A Convertible Preferred Stock and 50,000 shares of Series B Convertible Preferred Stock which were, during 2002, subsequently converted into shares of the Company's common stock.

The issuance of shares of preferred stock could adversely affect the voting power of holders of our common stock and the likelihood that these holders will receive dividends and payments upon liquidation of the Company and could have the effect of delaying, deferring or preventing a change in control of the Company. We have no current plans to issue any additional preferred stock in the next twelve months. Although the issuance of preferred stock may be necessary in order to raise additional capital.

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### ADDITIONAL DILUTION AS A RISK TO STOCKHOLDERS.

As of December 31, 2004, the Company had 39,571,134 shares of common stock outstanding, options to purchase a total of 10,538,214 shares of common stock and warrants to purchase a total of 8,096,422 shares of common stock. We are authorized to issue up to 75,000,000 shares of common stock and are therefore able to issue additional shares without being required to obtain shareholder approval. If we issue additional shares, or if our existing shareholders exercise or convert their outstanding options or notes, our other shareholders may find their holdings drastically diluted, which if it occurs, means that they will own a smaller percentage of the Company.

### ITEM 2. DESCRIPTION OF PROPERTY.

The Company leases office space in four locations. The following chart provides information related to these lease obligations:

| Office Location                  | Approximate<br>Square Footage | Lease Rental | Expiration<br>Date |
|----------------------------------|-------------------------------|--------------|--------------------|
| 3010 N. Military, Boca Raton, FL | 15,756                        | \$ 501,130   | 2/28/2009          |

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|                                     |       |            |            |
|-------------------------------------|-------|------------|------------|
| 880 Third Ave., New York, NY        | 3,098 | \$ 182,520 | 6/30/2008  |
| 131 Gaither Drive, Mount Laurel, NJ | 1,400 | \$ 19,600  | 7/31/2006  |
| 1 Revmont Drive, Shrewsbury, NJ     | 1,249 | \$ 27,659  | 10/31/2005 |

Our corporate headquarters are located at 3010 North Military Trail, Boca Raton, Florida 33431, where Colonial Direct Financial Group, Inc. leased approximately 15,750 square feet. The Company terminated the original lease and entered into a new lease in January 2003, as amended on October 31, 2003 and March 26, 2004. The January 2003 lease reduced the size of the leased space to approximately 9,877 square feet. On November 12, 2004, the Company entered into a new amendment in which the Company expanded the size of its premises to include an additional 5,879 rentable square feet of space effective January 1, 2005 (the "effective date"). As of the effective date, the lease was amended such that the premises shall be deemed to contain a total of 15,756 rentable square feet. The lease expiration date was also extended to February 28, 2009.

On December 15, 2004, we entered into a new lease at 880 Third Avenue, New York, New York to replace our two previous leases in the same building which expired on December 31, 2004. We now have offices on the twelfth floor with an annual rental of \$188,520 for approximately 3,098 square feet. The lease expires on June 30, 2008.

On August 1, 2004, the Company entered into a lease in Mt. Laurel, New Jersey. The opening of this office was part of the Company's disaster recovery plan implemented in order to be able to provide our clients with uninterrupted service. The lease is for approximately 1,400 square feet with an annual rental of \$19,600 and expires on July 31, 2006.

On September 4, 2003, we entered into a lease for our Shrewsbury, New Jersey office. The lease is for approximately 1,249 square feet with an annual rental of \$27,659 and expires October 31, 2005.

We consider the facilities of our company and our subsidiaries to be reasonably insured and adequate for the foreseeable needs of our company and its subsidiaries.

### ITEM 3. LEGAL PROCEEDINGS.

From time to time the Company, and/or one of its subsidiaries, is named as a party to a lawsuit that has arisen in the ordinary course of business. Although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, we believe that such losses, if any, will not have a material adverse effect on our business, results of operations or financial position; however, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

The business of vFinance Investments and EquityStation involve substantial risks of liability, including exposure to liability under federal and state securities laws in connection with the underwriting or distribution of securities and claims by dissatisfied customers for fraud, unauthorized trading, churning, mismanagement and breach of fiduciary duty. In recent years, there has been an increasing incidence of litigation involving the securities industry, including class actions that generally seek rescission and substantial damages.

In the ordinary course of business, the Company and/or its subsidiaries may be parties to other legal proceedings and regulatory inquiries, the outcome of which, either singularly or in the aggregate, is not expected to be material. There can be no assurance however that any sanctions will not have a material



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adverse effect on the financial condition or results of operations of the Company and/or its subsidiaries. The following is a brief summary of certain matters pending against or involving the Company and its subsidiaries.

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On August 20, 2001, we entered into a Securities Exchange Agreement by means of which we acquired the membership interests in two related companies, Critical Investments, LLC, a Delaware limited liability company ("Critical Investments"), and Critical Advisors, L.L.C., a Virginia limited liability company ("Critical Advisors"). Critical Investments manages Critical Infrastructure Fund, L.P. ("Critical Infrastructure LP"), a Delaware limited partnership. Critical Advisors manages Critical Infrastructure Fund, Ltd. ("Critical Infrastructure Ltd."), an international business company organized and existing under the laws of the British Virgin Islands and receives (i) a management fee equal to 1% of the net asset value of Critical Infrastructure Ltd. and (ii) a performance fee equal to 20% of the increase in net asset value of Critical Infrastructure Ltd. Critical Infrastructure LP and Critical Infrastructure Ltd. are the sole general partners in, owning 96% and 4%, respectively, and conduct their investment and trading activity through Critical Infrastructure Fund (BVI), LP, a limited partnership organized and existing under the laws of the British Virgin Islands, which holds a portfolio of securities. A determination has been made to liquidate the funds. The SEC is conducting a non-public investigation relating to Critical Infrastructure LP, Critical Investments and Critical Advisors. The Company is cooperating with this investigation. Critical Investments and Critical Advisors changed their names to vFinance Investors, LLC and vFinance Advisors, LLC, respectively, subsequent to the acquisition.

On August 14, 2002, Henry S. Snow and Sandra L. Snow filed a complaint against Colonial Direct and vFinance, Inc. in the Circuit Court of the 15th Judicial Circuit in Palm Beach County, Florida. The claim alleges "Breach of Contract" and "Unjust Enrichment" and seeks damages of \$250,000 plus interest and court costs. It is alleged that Colonial Direct defaulted on a Promissory Note in the principal amount of \$250,000. The Company believes their claim is without merit and is vigorously defending the action.

On October 23, 2002, Henry Shoemaker, III, filed a claim with the NASD against First Level Securities, now known as vFinance Investments, Inc., stating among other things, that there was a breach of fiduciary duties resulting in a loss of \$570,000. This matter went to the arbitration panel during 2004 and Mr. Shoemaker was awarded \$15,000. Mr. Shoemaker filed an action in the Parish of Orleans requesting that the arbitration be vacated. vFinance Investments filed a motion to remove the matter to Federal Court. Federal Court denied his request to vacate the arbitration. Mr. Shoemaker then appealed to Federal Courts ruling to the United States Court of Appeal for the 5th Circuit. This matter is still pending.

On January 12, 2003, MP 830 Third Avenue LLC ( the Landlord), filed a claim against First Colonial, vFinance, Inc. and vFinance Investments Inc. in the Supreme Court of the State of New York, alleging the abandonment of leased facilities and seeking payment of the related rent. The lease was for a term of seven years expiring on December 31, 2006. First Colonial allegedly ceased paying rent as of July 1, 2002. After applying First Colonial's security deposit of \$200,000, the Landlord is seeking \$59,868 plus any further rent due until such time as they can successfully lease the premises at a similar rate. This matter was settled on December 6, 2004 in the amount of \$100,000.

On April 15, 2003, Ms. Madeline Moore filed a claim with the NASD against vFinance Investments, Inc. in the amount of \$150,527 claiming a breach of

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fiduciary duties. This matter was settled on February 27, 2004 in the amount of \$125,000.

On October 17, 2003, we were advised by the staff of the SEC that it intended to recommend that the SEC institute enforcement proceedings against vFinance Investments and one of its former employees. The SEC claims that vFinance Investments and its former employee failed reasonably to supervise the alleged illegal trading activities over a period of approximately two months of one of our broker/dealer's former securities traders with respect to one publicly traded security that resulted in vFinance Investments earning \$11,000 in commissions related to that one security over the two month period. As of December 31, 2004, the Company has included an accrual of \$50,000 for estimated expenses. On March 17, 2005 we were advised by a member of the staff of the SEC that the SEC had accepted our offer to settle the matter. Pursuant to the terms of the settlement, vFinance Investments is required to make its first payment of the \$50,000 penalty (\$16,667) within 30 days of the entry of the Order. In addition, the Company will need to retain, within 60 days of the date of the Order, an independent consultant to conduct a review of vFinance's existing procedures regarding the supervision of traders to ensure that they are adequate. The Company believes that this matter will not have a material adverse affect on its business and operations.

On November 13, 2003, UBUY Holdings, Inc., f/k/a E-PAWN.COM, Inc., and Steven Bazuly, for and on behalf of all of the shareholders of UBUY Holdings, Inc. filed an amended complaint for damages and consequential damages against vFinance Investments, Inc. and approximately 60 other defendants in the United States District Court for the Southern District of Florida stating, among other things, that there were violations of certain securities rules and regulations. The Company has not yet been served with this complaint, but in the event it is, the Company believes that their claim is without merit and will vigorously defend this action.

On March 15, 2004 Joseph & Joan Barr filed a claim with the NASD against Pittsford Capital Markets, vFinance Investments, Inc. and others, claiming that VFIN was the successor firm to Pittsford Capital Markets and alleging, among other things, that in 1998 he purchased Private Placements that were unsuitable. The claim alleged damages of \$700,000. The Company believes their claim is without merit and is vigorously defending the action.

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On or about February 28, 2005, Knight Equity Markets, L.P. ("Knight") commenced an arbitration proceeding with the National Association of Securities Dealers Inc. by filing a Statement of Claim against vFinance Investments, Inc., and one of vFinance's registered representatives, Steven Soskin. The matter is titled Knight Equity Markets, L.P. v. vFinance Investments, Inc., and Steven Soskin, NASD Case No. 05-01069. Knight alleges that vFinance and Mr. Soskin were engaged in a fraudulent scheme to buy various stocks at ex-dividend prices that vFinance and Mr. Soskin knew were subject to dividends. Knight further alleges that vFinance received \$6.5 million in dividends that it was not otherwise entitled to receive. Knight seeks a declaration that vFinance was not entitled to receive the dividends, \$6.5 million in damages, attorneys fees, costs and an unspecified amount of punitive damages. The matter is currently in the pleadings phase. . The primary customer involved in the subject stock purchases has now filed an action in the Supreme Court for the State of New York against Knight seeking a Declaratory Judgment and Equitable Relief with regard to the subject dividends. This action seeks a declaratory judgment that the customer is the rightful owner of the \$5.8 million in dividends. The Company believes that Knight's claim is without merit, and the Company will vigorously defend the action.

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We are engaged in a number of other legal proceedings incidental to the conduct of our business. These claims aggregate a range of \$28,000 to \$260,000.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matters were submitted to a vote of stockholders during the fourth quarter of fiscal year 2004.

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## PART II

### ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

Our common stock, par value \$0.01 per share, is traded on the OTC Bulletin Board of the National Association of Securities Dealers, Inc. under the symbol "VFIN."

The following table sets forth the closing high and low bid information for our common stock for the periods indicated below, as reported by the National Quotation Bureau during such periods:

|             | High | Low  |
|-------------|------|------|
| 2003        |      |      |
| 1st Quarter | 0.17 | 0.05 |
| 2nd Quarter | 0.26 | 0.06 |
| 3rd Quarter | 0.20 | 0.11 |
| 4th Quarter | 0.36 | 0.14 |
| 2004        |      |      |
| 1st Quarter | 0.45 | 0.22 |
| 2nd Quarter | 0.37 | 0.31 |
| 3rd Quarter | 0.21 | 0.19 |
| 4th Quarter | 0.34 | 0.17 |

The foregoing quotations supplied by the National Quotations Bureau reflect inter-dealer prices, without retail mark-up, markdown or commission and may not represent actual transactions.

We are authorized to issue 75,000,000 shares of common stock, of which 40,126,133 shares were issued and outstanding as of March 28, 2005. We are authorized to issue up to 2,500,000 shares of preferred stock, none of which are currently issued or outstanding. The number of stockholders of record for the common stock as of March 28, 2004 is 302.

We have not paid any cash dividends since inception, and we do not anticipate paying any cash dividends in the foreseeable future.

Our transfer agent is North American Transfer Co., Freeport, New York 11520.

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### ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION OR PLAN OF OPERATIONS

#### CRITICAL ACCOUNTING POLICIES

Financial Reporting Release No. 60, released by the SEC, requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 2 to our consolidated financial statements includes a summary of the significant accounting policies and methods used in the preparation of our consolidated financial statements. The following is a brief discussion of the more significant accounting policies and methods used by us.

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

#### REVENUE RECOGNITION

The Company earns revenue (commissions) from brokerage and trading which are recognized on the day of the trade - trade date basis. The Company also earns revenue from investment banking and consulting. Monthly retainer fees for investment banking and consulting are recognized as services are provided. Investment banking success fees are generally based on a percentage of the total value of a transaction and are recognized upon successful completion.

The Company does not require collateral from its customers. Revenues are not concentrated in any particular region of the country or with any individual or group.

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The Company may receive equity instruments which include stock purchase warrants and common and preferred stock from companies as part of its compensation for investment-banking services that are classified as investments in trading securities on the balance sheet, if still held at the financial reporting date. Primarily all of the equity instruments are received from small public companies. The Company recognizes revenue for such stock purchase warrants when received based on the Black Scholes valuation model. On a monthly basis the Company recognizes unrealized gains or losses in the statement of operations based on the changes in value in the stock purchase warrants as determined by the Black Scholes valuation model. Realized gains or losses are recognized in the statement of operations when the related stock purchase warrant is exercised and sold. For the years ended December 31, 2004 and 2003, the Company recognized \$419,365 and \$777,669 of revenue in connection with the receipt of equity instruments.

Occasionally, the Company receives equity instruments in private companies with no readily available market value. Equity interests and warrants for which there is not a public market, are valued based on factors such as significant equity financing by sophisticated, unrelated new investors, history of positive cash flow from operations, the market value of comparable publicly traded companies (discounted for liquidity) and other pertinent factors. Management also considers recent offers to purchase a portfolio company's securities and the filings of registration statements in connection with a portfolio company's initial public offering when valuing warrants.

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As of December 31, 2004, certain transactions in process may result in the Company receiving equity instruments or stock purchase warrants in subsequent periods as discussed above. In such event, the Company will recognize revenue related to the receipt of such equity instruments consistent with the aforementioned policies.

The Company sells two types of listings through its website: (i) perpetual listings to venture capital vendors, who are interested in providing services to other companies or individuals; and (ii) three-month listings to entrepreneurs who have new business ideas to sell. Revenue related to the listings is generally recognized over the terms of such listings. Website revenues are concentrated primarily in the United States but are not concentrated in any particular region of the country or with any individual or group. Fees related to such listings are included in "other" in the statements of operations for the years ended December 31, 2004 and 2003.

**CLEARING ARRANGEMENT.** We do not carry accounts for customers or perform custodial functions related to customers' securities. We introduce all of their customer transactions, which are not reflected in these financial statements, to their respective clearing brokers, which maintain the customers' accounts and clear such transactions. Additionally, our clearing firms provides the clearing and depository operations for our proprietary securities transactions. These activities may expose our broker dealer to off-balance-sheet risk in the event that customers do not fulfill their obligations with the clearing broker; in this event, our broker dealers have agreed to indemnify our clearing firms.

**NET CAPITAL REQUIREMENT.** As of December 31, 2004, the minimum amount of net capital required to be maintained by vFinance Investments was \$1,000,000. The minimum amount of capital required to be maintained by EquityStation was \$100,000 pursuant to NASD requirements. However, EquityStation has agreed to maintain a minimum of \$250,000 in net capital pursuant to its agreement with its clearing agent, Merrill Lynch.

**CUSTOMER CLAIMS.** In the normal course of business, our operating subsidiaries have been and continue to be the subject of numerous civil actions and arbitrations arising out of customer complaints relating to our activities as a broker-dealer, as an employer and as a result of other business activities. In general, the cases involve various allegations that our employees had mishandled customer accounts. Based on our historical experience and consultation with counsel, we typically reserve an amount we believe will be sufficient to cover any damages assessed against us. However, we have in the past been assessed damages that exceeded our reserves. If we misjudged the amount of damages that may be assessed against us from pending or threatened claims, or if we are unable to adequately estimate the amount of damages that will be assessed against us from claims that arise in the future and reserve accordingly, our operating income would be reduced.

**STOCK BASED COMPENSATION.** Upon the consummation of an advisory, consulting, capital or other similar transactions the Company may distribute equity instruments or proceeds from the sale of equity instruments to its employees. These distributions are made at the Company's discretion on a case by case basis as determined by the role of the employee and the nature of the transaction. At December 31, 2004 and 2003, no amounts were owed to employees of the Company in connection with equity investments received as compensation.

**FAIR VALUE.** "Trading securities owned" and "Securities sold, not yet purchased" on our consolidated statements of financial condition are carried at fair value or amounts that approximate fair value, with related unrealized gains and losses recognized in our results of operations. The determination of fair value is fundamental to our financial condition and results of operations and, in certain circumstances, it requires management to make complex judgments.

Fair values are based on listed market prices, where possible. If listed market prices are not available or if the liquidation of our positions would reasonably be expected to impact market prices, fair value is determined based on other relevant factors, including dealer price quotations. Fair values for certain derivative contracts are derived from pricing models that consider current market and contractual prices for the underlying financial instruments or commodities, as well as time value and yield curve or volatility factors underlying the positions.

Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different pricing models or assumptions could produce different financial results. Changes in the fixed income and equity markets will impact our estimates of fair value in the future, potentially affecting principal trading revenues. The illiquid nature of certain securities or debt instruments also requires a high degree of judgment in determining fair value due to the lack of listed market prices and the potential impact of the liquidation of our position on market prices, among other factors.

YEAR ENDED DECEMBER 31, 2004 COMPARED TO THE YEAR ENDED DECEMBER 31, 2003

#### STATEMENTS OF OPERATIONS

##### Business Environment

The securities industry is highly competitive and sensitive to many factors and is directly affected by general economic and market conditions, including the volatility and price level of securities markets; the trading volume, size, and timing of securities transactions; the demand for investment banking services and changes in interest rates. All such conditions have an impact on commissions, trading and investment income as well as on liquidity. In addition, a significant portion of the Company's expenses are relatively fixed and do not vary with market activity. Consequently, substantial fluctuations can occur in the Company's revenues and net income from period to period due to these and other factors.

In addition, the Company continues to face increasing competition from commercial banks and other large financial services firms as they begin to offer more investment banking and financial services traditionally provided by securities firms. The effect of the consolidation of the securities industry of recent years means that a variety of financial services companies have merged to offer a broader spectrum of investment products and such competitors have substantially greater financial resources than the Company. The Company is incurring additional expenses to comply with increased regulation from the Sarbanes-Oxley Act and the securities industry, particularly in the over-the-counter markets. At present, the Company is unable to predict the extent of the changes, or their potential effect on the Company's business.

##### Outlook

The Company will continue executing its plan for growth and profitability by investing in its core businesses and through merger and acquisition. Due to the many complexities of purchasing companies, the Company cannot predict its success in executing this strategy. The Company will leverage the substantial investments in technology and infrastructure made in 2004 by adding independent contractors to its retail brokerage and investment banking businesses. The

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Company will expand its institutional sales business by focusing on providing a full range of investment, research and trading services to the Hedge Fund Industry. Furthermore, the Company plans to find opportunities to expand its newly acquired emerging markets fixed income securities trading business.

### Results of Operations

During 2004, the Company's revenues grew by 7.6% and continued its profitability from 2003, compared to the significant net losses incurred in prior years. The Company achieved operating profitability in each fiscal quarter even though the financial markets in fiscal 2004 were volatile. During the first quarter, net income was strong due to favorable market conditions, the recognition of a gain of \$1,500,000 for the forgiveness of indebtedness, the recognition of a tax benefit in the amount of \$400,000 and income received from its clearing agent in the amount of \$200,000 which reduced transaction costs; this was offset by a one-time conversion premium expense in the amount of \$231,625. Markets softened during the second quarter but the Company achieved profitability. The results for the third quarter were further impacted by continued unfavorable market conditions. In the fourth quarter, market conditions strengthened in the retail brokerage segment and the Company realized a gain of \$775,489 on the sale of securities; this was offset by the reversal of the \$400,000 tax benefit realized in the first quarter.

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The following table and discussion summarizes the changes in the major revenue and expense categories for the past two years.

|                                | Years ended December 31, |                  |                   |                  |
|--------------------------------|--------------------------|------------------|-------------------|------------------|
|                                | 2004                     | % of<br>Revenues | 2003              | % of<br>Revenues |
| <b>Revenues:</b>               |                          |                  |                   |                  |
| Commissions - agency           | \$ 14,571,878            | 55%              | \$13,372,875      | 55%              |
| Trading Profits                | 5,156,842                | 20%              | 4,533,933         | 19%              |
| Success fees                   | 3,224,973                | 12%              | 3,549,453         | 15%              |
| Consulting and retainers       | 370,829                  | 1%               | 468,168           | 2%               |
| Other brokerage related income | 2,567,489                | 10%              | 2,085,313         | 9%               |
| Other                          | 437,140                  | 2%               | 468,724           | 2%               |
| <b>Total revenues</b>          | <b>26,329,151</b>        | <b>100%</b>      | <b>24,478,466</b> | <b>100%</b>      |
| <b>Cost of revenues:</b>       |                          |                  |                   |                  |
| Commissions                    | 14,624,914               | 55%              | 13,234,856        | 54%              |
| Clearing and transaction costs | 1,030,114                | 4%               | 934,884           | 4%               |
| Success                        | 1,346,272                | 5%               | 1,792,760         | 7%               |
| Consulting and retainers       | 224,916                  | 1%               | 218,807           | 1%               |
| Other                          | 4,581                    | 0%               | 16,138            | 0%               |
| <b>Total cost of revenues</b>  | <b>17,230,797</b>        | <b>65%</b>       | <b>16,197,445</b> | <b>66%</b>       |
| <b>Gross profit</b>            | <b>9,098,354</b>         | <b>35%</b>       | <b>8,281,021</b>  | <b>34%</b>       |
| <b>Other expenses:</b>         |                          |                  |                   |                  |
| General and administrative     | 6,686,372                | 25%              | 6,776,221         | 28%              |

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|  |              |       |            |       |
|--|--------------|-------|------------|-------|
| Professional fees                          | 157,370      | 1%    | 324,712    | 1%    |
| Provision for bad debts                    | 85,567       | 0%    | 148,672    | 1%    |
| Legal litigation                           | 399,647      | 2%    | 327,499    | 1%    |
| Depreciation and<br>amortization           | 147,804      | 1%    | 118,619    | 0%    |
| Amounts forgiven under<br>forgivable loans | 80,161       | 0%    | 152,902    | 1%    |
| Stock based compensation                   | 5,294        | 0%    | 17,714     | 0%    |
|  | -----        | ----- | -----      | ----- |
| Total other expenses                       | 7,562,215    | 29%   | 7,866,339  | 32%   |
|  | -----        | ----- | -----      | ----- |
| Income from operations                     | 1,536,139    | 6%    | 414,682    | 2%    |
| Gain on forgiveness of debt                | 1,500,000    | 6%    | -          | 0%    |
| Interest and dividend income<br>(expense)  | (221,704)    | -1%   | (103,267)  | 0%    |
|  | -----        | ----- | -----      | ----- |
| Pre-Tax Net Income                         | 2,814,435    | 11%   | 311,415    | 1%    |
|  | -----        | ----- | -----      | ----- |
| Federal Income Taxes                       | (40,000)     | 0%    | -          | 0%    |
|  | -----        | ----- | -----      | ----- |
| Net Income                                 | \$ 2,774,435 | 11%   | \$ 311,415 | 1%    |
|  | =====        | ===== | =====      | ===== |

Total revenues were \$26,329,151 for the year ended December 31, 2004 as compared to \$24,478,466 for the year ended December 31, 2003, an increase of \$1,850,685, or 7.6 %. The increase in revenues was primarily related to Brokerage and Trading which increased \$2,304,088, or 11.52% from the prior year, partially offset by a decrease in Investment Banking which decreased \$421,819, or 10.50%, from the prior year. Overall, the Company believes that the increase in its operating revenues was a result of more favorable market conditions than in the prior year, the Global acquisition and expense reductions.

Cost of revenues was \$17,230,797 for the year ended December 31, 2004 as compared to \$16,197,445 for the year ended December 31, 2003, an increase of \$1,033,352, or 6.4%. The increase was primarily due to the increase in commission expense corresponding to the increased revenues.

Gross profit was \$9,098,354 for the year ended December 31, 2004 as compared to \$8,281,021 for the year ended December 31, 2003, an increase of \$817,333, or 9.9%. Gross profit margin for the year ended December 31, 2004 was 35% as compared to 34% for the year ended December 31, 2003. The increase in gross profit margin was due to an increase of \$602,440 in realized profits from the sale of securities compared to the prior year with no corresponding expense and the \$200,000 provided by NFS to assist the Company with transition costs related to the conversion from CSC to NFS.

General and administrative expenses were \$6,686,372 for the year ended December 31, 2004 as compared to \$6,776,221 for the year ended December 31, 2003, a decrease of \$89,849, or 1.3%. This decrease was primarily attributable to cost saving measures that were implemented throughout the organization.

Professional fees were \$157,370 for the year ended December 31, 2004 as compared to \$324,712 for the year ended December 31, 2003, a decrease of \$167,342, or 51.5%. The decrease was primarily due to decreases in accounting, legal and consulting fees largely attributable to the Company's increased utilization of its internal professional staff.



Provision for bad debts was \$85,567 for the year ended December 31, 2004 as compared to \$148,672 for the year ended December 31, 2003, a decrease of approximately \$63,105, or 42.4%. The decrease was primarily due to a significant reduction in retainer fees, which often prove difficult to collect. Retainer fees are recognized as services are provided. We provide for credit losses at the time we believe accounts receivable may not be collectible. Our evaluation is made and recorded on a monthly basis. Credit losses have not exceeded management's expectations.

Legal litigation was \$399,647 for the year ended December 31, 2004 as compared to \$327,499 for the year ended December 31, 2003, an increase of \$72,148, or 22%. As is typical in the industry, customers make claims regarding the Company's actions and the Company defends itself vigorously against such claims. The Company's cost of defending itself varies year-to-year depending on the volume of claims which are in process at any given time.

Depreciation and amortization was \$147,804 for the year ended December 31, 2004 as compared to \$118,619 for the year ended December 31, 2003, an increase of \$29,185 or 25%. The increase is primarily due to the Company's investment in new systems and technologies as a strategy to introduce new services that exceed compliance requirements and offer a comprehensive business solution thereby increasing productivity while reducing regulatory risk.

The amount forgiven under forgivable loans was \$80,161 for the year ended December 31, 2004 as compared to \$152,902 for the year ended December 31, 2003, a decrease of \$72,741, or 48%. This decrease was attributable to the fact that several years ago the Company discontinued its practice of providing forgivable loans to brokers as part of its recruitment efforts. Accordingly, there have been no additions to the outstanding balance and the remaining balance is simply being amortized over time.

Stock based compensation was \$5,294 for the year ended December 31, 2004 as compared to \$17,714 for the year ended December 31, 2003 a decrease of \$12,420, or 70%. This amount primarily represents the amortization of deferred compensation to an outside consultant who was granted options from the Company in return for his services. The amount related to this consultant was fully recognized as of March 31, 2003. In addition, during January 2003, the Company granted warrants to its landlord related to the renegotiation of its lease and this amount is being amortized over the life of the lease.

Income from operations amounted to \$1,536,139 for the year ended December 31, 2004 as compared to \$414,682 for the year ended December 31, 2003, an increase of \$1,121,457. The increase was primarily due to the higher revenues and the resulting gross profit and reduced operating expenses.

Income from forgiveness of indebtedness amounted to \$1,500,000 for the year ended December 31, 2004, which was the result of NFS agreeing to pay down the UBS credit facility.

Interest expense, net of interest and dividend income, was \$221,704 for the year ended December 31, 2004 as compared to \$103,267 for the year ended December 31, 2003, an increase in the amount of \$118,437. This increase was primarily attributable to the amount recorded as beneficial conversion premium on the SBI note.

We do not believe our operations are materially affected by inflation and or by seasonal fluctuations. Our main lines of business are directly affected by higher interest rates, the volatility and volume of the stock market and the

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capital markets.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the year ended December 31, 2004 was \$1,678,281 compared to \$1,484,387 for the year ended December 31, 2003 an increase of \$193,894. The increase in cash provided from operating activities is primarily attributable to improvement in net income offset by changes in working capital. The Company's net income for fiscal year 2004 was \$2,774,435 versus \$311,415 for fiscal year 2003. Net income in 2004 included a non-cash gain of \$1,500,000 for forgiveness of debt.

Net cash used in investing activities for the year ended December 31, 2004 was \$394,090 as opposed to \$57,734 for the year ended December 31, 2003. The primary reason for the increase is due to investments in technology the Company made to introduce new services to our existing clients and our affiliates and to ensure that the firm was positioned to continuously service in clients in the event of either a manmade or natural disaster. As part of that investment, the Company revamped its entire data and communications infrastructure. The Company has implemented a fully operational disaster recovery plan that features fully redundant data center in Mt. Laurel, New Jersey. In order to finance these capital expenditures, the Company entered into lease agreements (discussed below under cash provided by financing). The increase in cash used in investing activities was offset by the cash received as part of the acquisition of EquityStation.

Net cash provided by financing activities for the year ended December 31, 2004 was \$188,303 as opposed to \$130,000 for the year ended December 31, 2003. The increase is primarily due to the Company entering into certain capital lease agreements to finance its investment in information technology equipment.

The Company believes that its cash on hand is sufficient to meet its working capital requirements over the next 12 months. However, the Company may seek additional debt or equity financing in order to carry out its long-term business strategy. Such funding may be a result of bank borrowings, public offerings, private placements of equity or debt securities, or a combination thereof.

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### FUTURE AND CONTINGENT LIABILITIES:

The following statements are made in consideration of Financial Reporting Release (FR-61), LIQUIDITY AND OFF-BALANCE SHEET ARRANGEMENTS, CERTAIN TRADING ACTIVITIES, & TRANSACTIONS WITH RELATED AND CERTAIN OTHER PARTIES. We do not have "off-balance sheet arrangements."

We lease office space under the terms of operating leases. The following chart shows lease obligations including rental of real property and equipment.

| YEAR  | AMOUNT      |
|-------|-------------|
| 2005  | \$ 828,484  |
| 2006  | 797,233     |
| 2007  | 764,543     |
| 2008  | 599,654     |
| 2009  | 85,897      |
|       | -----       |
| TOTAL | \$3,075,811 |
|       | =====       |

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Total rent expense under operating leases, including space rental, totaled approximately \$690,414 and \$700,464 for the years ended December 31, 2004 and 2003.

### Litigation:

From time to time we are a party to various lawsuits that have arisen in the ordinary course of business. The amounts asserted in these matters are material to our financial statements. While any litigation contains an element of uncertainty and although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, management believes that such losses, if any, will not have a material adverse effect on our business, results of operations or financial position. However, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

For a description of this litigation, see Part I, Item 3 of this Annual Report.

### SUBSEQUENT EVENTS

Subsequent to December 31, 2004, the Company came to an agreement in principle with The Center for Innovative Entrepreneurship ("CIE"), a nonprofit organization, to develop [www.vfinance.com](http://www.vfinance.com) as a platform for academic-quality research on entrepreneurial activities and to produce the Company's proprietary vFinance Entrepreneurial Confidence Index ("VECI") and sector research reports, and to provide educational and informational services to entrepreneurs with start-ups and other early-stage firms. The Company also agreed to enter into a management services agreement to provide management, administrative and technical support services for CIE. It is anticipated that the Company and CIE will enter into definitive documentation evidencing these agreements in April 2005.

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### ITEM 7. FINANCIAL STATEMENTS.

vFinance, Inc.

Consolidated Financial Statements

Years ended December 31, 2004 and 2003

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders  
vFinance Inc., & Subsidiaries

We have audited the accompanying balance sheet of vFinance Inc., & Subsidiaries, as of December 31, 2004 and the related statements of operations, shareholders' equity and cash flows for the years ended December 31, 2004 and 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of vFinance Inc., & Subsidiaries, at December 31, 2004, and the results of its operations and its cash flows for the years ended December 31, 2004 and 2003, in conformity with accounting principles generally accepted in the United States.

/s/ Sherb & Co., LLP  
Certified Public Accountants

Boca Raton, Florida  
March 29, 2005

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vFINANCE, INC.  
CONSOLIDATED BALANCE SHEET

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|   | December 31, 2004 |
|---|-------------------|
|   | -----             |
| Assets:   |                   |
| Current Assest:   |                   |
| Cash and cash equivalents   | \$ 5,256,308      |
| Due from clearing broker  | 667,074           |
| Investments in trading securities   | 916,365           |
| Accounts receivable, net of allowance<br>for doubtful accounts of \$6,014   | 89,545            |
| Forgivable loans-employees  | 6,597             |
| Notes receivable-employees  | 168,702           |
| Prepaid expenses and other current assets   | 97,908            |
|   | -----             |
| Total current assets  | 7,202,499         |
| Furniture and equipment, at cost:   |                   |
| Furniture and equipment   | 905,465           |
| Internal use software   | 158,500           |
|   | -----             |
|   | 1,063,965         |
| Less accumulated depreciation   | (565,526)         |
|   | -----             |
| Net furniture and equipment   | 498,439           |
| Goodwill  | 1,866,848         |
| Other assets  | 264,605           |
|   | -----             |
| Total Assets  | \$ 9,832,391      |
|   | =====             |
| Liabilities and Shareholders' Equity:   |                   |
| Current liabilities:  |                   |
| Accounts payable  | \$ 1,134,148      |
| Accrued payroll   | 1,568,086         |
| Other accrued liabilities   | 526,233           |
| Income tax payable  | 40,000            |
| Securities sold, not yet purchased  | 67,470            |
| Capital lease obligations   | 65,355            |
| Other   | 34,097            |
|   | -----             |
| Total current liabilities   | 3,435,389         |
| Capital lease obligations, long term  | 122,948           |
| Shareholders' Equity:   |                   |
| Series A Convertible Preferred Stock \$0.01 par<br>value, 122,500 shares authorized, 0 shares issued<br>and outstanding | -                 |
| Series B Convertible Preferred Stock \$0.01 par<br>value, 50,000 shares authorized, 0 shares issued<br>and outstanding  | -                 |
| Common stock \$0.01 par value, 75,000,000 shares<br>authorized, 39,571,133 issued and outstanding                       | 395,716           |

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|  |    |              |
|--|----|--------------|
| Additional paid-in-capital                 |    | 26,713,557   |
| Deferred compensation                      |    | (19,411)     |
| Accumulated deficit                        |    | (20,815,808) |
|  |    | -----        |
| Total Shareholders' Equity                 |    | 6,274,054    |
|  |    | -----        |
| Total Liabilities and Shareholders' Equity | \$ | 9,832,391    |
|  |    | =====        |

See Accompanying Notes

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vFINANCE, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

|  | Years Ended December 31, |               |
|--|--------------------------|---------------|
|  | 2004                     | 2003          |
|  | -----                    | -----         |
| Revenues:                                  |                          |               |
| Commissions - agency                       | \$ 14,571,878            | \$ 13,372,875 |
| Trading profits                            | 5,156,842                | 4,533,933     |
| Success Fees                               | 3,224,973                | 3,549,453     |
| Consulting and retainers                   | 370,829                  | 468,168       |
| Other brokerage related income             | 2,567,489                | 2,085,313     |
| Other                                      | 437,140                  | 468,724       |
|  | -----                    | -----         |
| Total revenues                             | 26,329,151               | 24,478,466    |
|  | -----                    | -----         |
| Cost of revenues:                          |                          |               |
| Commissions                                | 14,624,914               | 13,234,856    |
| Clearing and transaction costs             | 1,030,114                | 934,884       |
| Success                                    | 1,346,272                | 1,792,760     |
| Consulting and retainers                   | 224,916                  | 218,807       |
| Other                                      | 4,581                    | 16,138        |
|  | -----                    | -----         |
| Total cost of revenues                     | 17,230,797               | 16,197,445    |
|  | -----                    | -----         |
| Gross profit                               | 9,098,354                | 8,281,021     |
|  | -----                    | -----         |
| Other expenses:                            |                          |               |
| General and administrative                 | 6,686,372                | 6,776,221     |
| Professional fees                          | 157,370                  | 324,712       |
| Provision for bad debt                     | 85,567                   | 148,672       |
| Legal litigation                           | 399,647                  | 327,499       |
| Depreciation and amortization              | 147,804                  | 118,619       |
| Amounts forgiven under<br>forgivable loans | 80,161                   | 152,902       |
| Stock based compensation                   | 5,294                    | 17,714        |

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|   |              |            |
|---|--------------|------------|
| Total other expenses  | 7,562,215    | 7,866,339  |
| Income from operations  | 1,536,139    | 414,682    |
| Gain on forgiveness of debt   | 1,500,000    | -          |
| Interest and dividend income (expense)  | (221,704)    | (103,267)  |
| Pre-tax Net Income  | 2,814,435    | 311,415    |
| Federal income tax  | (40,000)     | -          |
| Net Income available to common shareholders   | \$ 2,774,435 | \$ 311,415 |
| Net Income per share:   |              |            |
| Basic   | \$ 0.08      | \$ 0.01    |
| Weighted average number of common shares used in computing basic net income per share   | 33,773,336   | 29,609,104 |
| Diluted   | \$ 0.08      | \$ 0.01    |
| Weighted average number of common shares used in computing diluted net income per share | 35,840,248   | 29,963,446 |

See Accompanying Notes

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vFinance, Inc.  
Consolidated Statements of Shareholders' Equity

|   | Preferred Stock | Common Stock | Additional Paid | Defer   |
|---|-----------------|--------------|-----------------|---------|
|   | Shares          | Shares       | in              | Compen  |
|   | Amount          | Amount       | Capital Common  |         |
| Balance at December 31, 2002                                    | -               | 28,351,570   | \$ 24,151,798   | \$ (12, |
| Issuance of shares in conjunction with share purchase agreement |                 | 1,500,000    | 115,000         |         |
| Amortization of Deferred Compensation                           |                 |              |                 | 12,     |
| Acquisition of JSM  |                 |              | 80,000          |         |

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|  |   |   |            |            |               |
|--|---|---|------------|------------|---------------|
| Issuance of stock purchase warrants in conjunction with lease agreement                      | - |   |            | 30,000     | (30,000)      |
| Amortization of Deferred Compensation  |   |   |            |            | 5,000         |
| Net Income   |   |   |            |            |               |
| -----  |   |   |            |            |               |
| Balance at December 31, 2003   | - | - | 29,851,570 | \$ 298,520 | \$ 24,376,798 |
| Partial conversion of promissory note  |   |   | 3,344,298  | 33,443     | 688,057       |
| Conversion Premium on promissory note  |   |   |            |            | 231,625       |
| Imputed Interest write off   |   |   |            |            | (128,438)     |
| Amortization of Deferred Compensation  |   |   |            |            | 5,000         |
| Partial conversion of promissory note  |   |   | 100,000    | 1,000      | 27,500        |
| Issuance of shares in conjunction with acquisition of EquityStation Inc. and Global Partners |   |   | 6,275,265  | 62,753     | 1,518,015     |
| Net Income   |   |   |            |            |               |
| -----  |   |   |            |            |               |
| Balance at December 31, 2004   | - | - | 39,571,133 | \$ 395,716 | \$ 26,713,557 |
| =====  |   |   |            |            |               |

See Accompanying Notes

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vFINANCE, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Years ended December 31, |           |
|---|--------------------------|-----------|
|   | 2004                     | 2003      |
|   | -----                    | -----     |
| OPERATING ACTIVITIES  |                          |           |
| Net income  | \$ 2,774,435             | \$ 31,000 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |           |
| Non-cash fees received  | (419,365)                | (77,000)  |
| Gain on forgiveness of debt   | (1,500,000)              | 11,000    |
| Depreciation and amortization   | 147,804                  | 14,000    |
| Provision for doubtful accounts   | 79,817                   | 39,000    |
| Non-cash compensation   | 5,492                    | 7,000     |
| Conversion premium expense  | 231,625                  | 8,000     |
| Accretion of debt discount  | 18,349                   | 4,000     |
| Unrealized loss (gain) on investments, net  | 211,854                  | 15,000    |
| Unrealized loss (gain) on warrants  | (41,194)                 | 1,000     |
| Amount forgiven under forgivable loans  | 80,161                   | 1,000     |
| Stock based compensation  | 5,294                    | 1,000     |
| Changes in operating assets and liabilities:                                      |                          |           |
| Accounts receivable   | 26,196                   | (3,000)   |
| Due from clearing broker  | (297,984)                | (7,000)   |
| Notes receivable - employees  | 14,527                   | (1,000)   |
| Investments in trading securities   | 328,880                  | 49,000    |
| Other assets and liabilities  | (39,440)                 | (10,000)  |
| Accounts payable and accrued liabilities  | 68,140                   | 64,000    |
| Securities, sold not yet purchased  | (16,310)                 | 1,000     |



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|  |              |         |
|--|--------------|---------|
| Net cash provided by operating activities                              | 1,678,281    | 1,48    |
| INVESTING ACTIVITIES   |              |         |
| Cash acquired in acquisition   | 56,221       |         |
| Purchase of capital lease equipment                                    | (204,583)    |         |
| Purchase of equipment  | (245,728)    | (5      |
| Net cash used in investing activities                                  | (394,090)    | (5      |
| FINANCING ACTIVITIES   |              |         |
| Proceeds from capital lease  | 204,583      |         |
| Payments of capital lease  | (16,280)     |         |
| Proceeds from issuance of common stock<br>related to private placement | -            | 13      |
| Net cash provided by financing activities                              | 188,303      | 13      |
| Increase in cash and cash equivalents                                  | 1,472,494    | 1,55    |
| Cash and cash equivalents at beginning of year                         | 3,783,814    | 2,22    |
| Cash and cash equivalents at end of period                             | \$ 5,256,308 | \$ 3,78 |

See Accompanying Notes

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vFinance, Inc.

Notes to the Consolidated Financial Statements

1. DESCRIPTION OF BUSINESS

vFinance, Inc. is a holding company engaged in the financial services business where our strategic focus is on servicing the needs of high net-worth and institutional investors and high growth companies. Through our principal operating subsidiary, vFinance Investments, Inc., a licensed broker-dealer, we provide investment banking, retail and institutional brokerage services in all 50 states and the District of Columbia. The Company also operates a second broker-dealer, EquityStation, Inc. ("EquityStation") which offers institutional traders, hedge funds and professional traders a suite of services designed to enhance their trading by offering services such as trading technology, routing software, hedge fund incubation, capital introduction and custodial services. The Company, through its website [www.vfinance.com](http://www.vfinance.com), provides financial information services to entrepreneurs and venture investors.

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS

Basis of Presentation

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The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All inter-company accounts have been eliminated in consolidation.

### Revenue Recognition

The Company earns revenue (commissions) from brokerage and trading which are recognized on the day of the trade - trade date basis. The Company also earns revenue from investment banking and consulting. Monthly retainer fees for investment banking and consulting are recognized as services are provided. Investment banking success fees are generally based on a percentage of the total value of a transaction and are recognized upon successful completion.

The Company does not require collateral from its customers. Revenues are not concentrated in any particular region of the country or with any individual or group.

The Company may receive equity instruments which include stock purchase warrants and common and preferred stock from companies as part of its compensation for investment-banking services that are classified as investments in trading securities on the balance sheet, if still held at the financial reporting date. These instruments are stated at fair value in accordance with SFAS #115 "Accounting for certain investments in debt and equity securities". Primarily all of the equity instruments are received from small public companies. The Company recognizes revenue for such stock purchase warrants, when received, based on the Black Scholes valuation model. The revenue recognized related to the other equity instruments is determined based on available market information, discounted by a factor reflective of the expected holding period for those particular equity instruments. For the years ended December 31, 2004 and 2003, the Company recognized \$419,365 and \$777,669, respectively, of revenue in connection with the receipt of equity instruments. On a monthly basis the Company recognizes unrealized gains or losses in its statement of operations based on the changes in value of equity instruments. Realized gains or losses are recognized in the statement of operations when the related equity instrument is sold.

Occasionally, the Company receives equity instruments in private companies with no readily available market value. Equity interests and warrants for which there is not a public market are valued based on factors such as significant equity financing by sophisticated, unrelated new investors, history of positive cash flow from operations, the market value of comparable publicly traded companies (discounted for liquidity) and other pertinent factors. Management also considers recent offers to purchase a portfolio company's securities and the filings of registration statements in connection with a portfolio company's initial public offering when valuing equity instruments received from a private company.

Upon the consummation of an advisory, consulting, capital or other similar transactions the Company may distribute equity instruments or proceeds from the sale of equity instruments to its employees. These distributions are made at the Company's discretion on a case by case basis as determined by the role of the employee and the nature of the transaction. At December 31, 2004 and 2003, no amounts were owed to current employees of the Company in connection with equity investments received as compensation.

As of December 31, 2004, certain transactions in process may result in the Company receiving equity instruments or stock purchase warrants in subsequent periods as discussed above. In such event, the Company will recognize revenue related to the receipt of such equity instruments consistent with the aforementioned policies.

vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Revenue Recognition (continued)

The Company sells two types of listings through its website: (i) perpetual listings to venture capital vendors, who are interested in providing services to other companies or individuals; and (ii) three-month listings to entrepreneurs who have new business ideas to sell. Revenue related to the listings is generally recognized over the terms of such listings. Website revenues are concentrated primarily in the United States but are not concentrated in any particular region of the country or with any individual or group. Fees related to such listings are included in "other" in the statements of operations for the years ended December 31, 2004 and 2003.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements. Actual results may differ from those estimates, and such differences may be material to the financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with maturities of three months or less when purchased.

Accounts and Notes Receivable

Accounts and notes receivable balances are reviewed monthly to determine the collectibility of such receivables. The Company records both a specific and general reserve on such balances as deemed appropriate.

Investments

Investments are classified as investments in trading securities and are held for resale in anticipation of short-term market movements or until such securities are registered or are otherwise unrestricted. Investments in trading securities include both trading account assets and equity instruments which the Company has received as part of its compensation for investment banking services. At December 31, 2004, investments consisted of common stock, corporate bonds and common stock purchase warrants held for resale.

Trading account assets, consisting of marketable equity securities, are stated at fair value. Unrealized gains or losses are recognized in the statement of operations on a monthly basis based on changes in the fair value of the security as quoted on national or inter-dealer stock exchanges. Realized gains or losses are recognized in the statement of operations as trading profits when the equity instruments are sold.

As mentioned above, the Company periodically receives equity instruments which include stock purchase warrants and common and preferred stock from companies as

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part of its compensation for investment-banking services. These instruments are stated at fair value in accordance with SFAS #115 "Accounting for certain investments in debt and equity securities" and EITF 00-8 "Accounting by a grantee for an equity instrument to be received in conjunction with providing goods or services." Primarily all of the equity instruments are received from small public companies. The stock and the stock purchase warrants received are typically restricted as to resale, although, the company generally receives a registration right within one year. Company policy is to resell these securities in anticipation of short-term market movements. The Company recognizes revenue for such equity instruments based on the fair value of the stock at the time equity instruments are granted and for stock purchase warrants based on the Black-Scholes valuation model. Unrealized gains or losses are recognized in the statement of operations on a monthly basis based on changes in the fair value of the security as quoted on national or inter-dealer stock exchanges, discounted by a factor to address the remaining period which the equity instrument is restricted as to resale.

Net unrealized gains related to investments in trading securities as of December 31, 2004, and 2003, aggregated \$170,660 and \$123,640, respectively. Net realized gains related to investments in trading securities as of December 31, 2004 and 2003 aggregated \$1,087,741 and \$485,302, respectively.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

Investments in trading securities and securities sold, not yet purchased, consist of trading and investment securities at market values at December 31, 2004, as follows:

|                  | Owned      | Sold, not yet purchased |
|------------------|------------|-------------------------|
| Corporate Stocks | \$ 787,876 | \$ 67,470               |
| Warrants         | 128,489    |                         |
| Total            | \$ 916,365 | \$ 67,470               |

At December 31, 2004, restricted equity securities had an aggregate fair value of \$96,139.

#### Securities Transactions

Proprietary securities transactions in regular-way trades are accrued and recorded on the trade date, as if they had settled. Profit and loss arising from all securities and commodities transactions entered into for the account and risk of the Company are recorded on a trade date basis. Customers' securities and commodities transactions are reported on a settlement date basis with related commission income and expense reported on a trade date basis.

Amounts receivable and payable for securities transactions that have not reached

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their contractual settlement date are recorded net on the balance sheet.

### Financial Instruments with Off-Balance Sheet Risk

The securities transactions of the Company's customers are introduced on a fully disclosed basis with a clearing broker-dealer. The Company holds no customer funds or securities. The clearing broker-dealer is responsible for execution, collection of and payment of funds, and receipt and delivery of securities relative to customer transactions. Off-balance sheet risk exists with respect to these transactions due to the possibility that customers may be unable to fulfill their contractual commitments wherein the clearing broker-dealer may charge any related losses to the Company. The Company seeks to minimize this risk through procedures designed to monitor the creditworthiness of its customers and to ensure that customer transactions are executed properly by the clearing broker-dealer.

### Stock Based Compensation

The Company has elected to follow Accounting Principles Board Opinion No. 25, ACCOUNTING FOR STOCK ISSUED TO EMPLOYEES ("APB 25"), and related interpretations in accounting for its employee stock options and employee stock purchase warrants because the alternative fair value accounting provided for under Statement of Financial Accounting Standards No. 123, ACCOUNTING FOR STOCK BASED COMPENSATION ("SFAS 123") and SFAS 148 ACCOUNTING FOR STOCK BASED COMPENSATION TRANSITION AND DISCLOSURE, AN AMENDMENT OF SFAS 123, requires the use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, if the exercise price of the Company's employee stock options or stock purchase warrants equals or exceeds the market price of the underlying stock on the date of grant no compensation expense is recognized.

### Fair Value of Financial Instruments

The fair values of the Company's financial instruments, which includes cash and cash equivalents, accounts and notes receivable, investments, accounts payable, and accrued expenses approximate their carrying values.

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash with high quality insured financial institutions.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

## 2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

### Furniture and Equipment

Furniture and equipment are stated on the basis of cost less accumulated depreciation and consists primarily of computer equipment. Depreciation is computed using the straight-line method over the estimated useful lives of the assets, 2-5 years, for financial reporting purposes. Depreciation expense for the years ended December 31, 2004 and 2003, totaled \$147,804 and \$118,619, respectively. Included in Furniture and Equipment is approximately \$200,000 of equipment acquired under capital leases.

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### Goodwill

The carrying value of goodwill as well as other long-lived assets are reviewed if the facts and circumstances suggest that they may be impaired. If this review indicates that the assets will not be recoverable, as determined based on the undiscounted estimated cash flows of the Company over the remaining amortization period, the Company's carrying values of the assets would be reduced to their estimated fair values in accordance with Statement of Financial Accounting Standards No. 144, ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS ("FAS 144"). Among other factors considered in such evaluation is the historical and projected operating performance of business operations, the operating environment and business strategy, competitive information and market trends. As a result of the acquisition of EquityStation and certain assets of Global in November 2, 2004, the Company recorded goodwill in the amount of \$1,446,848. The Company had goodwill of \$1,866,848 and \$420,000 as of December 31, 2004 and December 31, 2003, respectively, which constituted approximately 19% and 7%, respectively, of our total assets. Management evaluates this balance on an ongoing basis and believes that there has not been an impairment of its Goodwill or long-lived assets as of December 31, 2004.

### Income Taxes

The Company accounts for income taxes under the liability method in accordance with Statement of Financial Accounting Standards No. 109, ACCOUNTING FOR INCOME TAXES. Under this method, deferred income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

### Statement of Cash Flows

Supplemental disclosure of cash flow information:

Non-cash items affecting the statement of cash flows are as follows:

|  | 2004         | 2003       |
|--|--------------|------------|
|  | -----        | -----      |
| Cash paid for interest during the year                       | \$ 34,008    | \$ 125,717 |
| Non-cash items affecting investing and financing activities: |              |            |
| Conversion Premium expense                                   | \$ 231,625   | \$ -       |
| Imputed Interest   | \$ 18,349    | \$ -       |
| Common Stock issued for payment of Note                      | \$ 750,000   | \$ -       |
| Common Stock issued for Acquisition                          | \$ 1,580,768 | \$ -       |

### Earnings per Share

The Company calculates earnings per share in accordance with Statement of

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Financial Accounting Standards No. 128, EARNINGS PER SHARE ("SFAS No. 128"). In accordance with SFAS No. 128, basic earnings per share is computed using the weighted average number of shares of common stock outstanding and diluted earnings per share is computed using the weighted average number of shares of common stock and the dilutive effect of options and warrants outstanding, using the "treasury stock" method.

### Forgivable Loans

In order to remain competitive in the marketplace, the Company previously granted forgivable loans to certain employees. The terms of the loans ranged from two to five years with scheduled maturity dates from 2002 to 2005. For each year the employee is in good standing with the Company, the Company forgives a ratable portion of the loan and charges this amount to compensation expense. If the employee is terminated, the principal balance is due and payable within 120 days. The loans do not bear interest and interest is not imputed as collectibility of any such interest would not be probable. As of December 31, 2004, the balance of the forgivable loans was \$6,597, which is scheduled for forgiveness in 2005.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 2. SIGNIFICANT ACCOUNTING POLICIES AND OTHER MATTERS (CONTINUED)

#### Due from Clearing Broker

Receivables from brokers and dealers consist primarily of amounts due from the Company's clearing organization, which provides clearing and depository services for brokerage transactions on a fully disclosed basis.

### 3. ACQUISITIONS

On November 2, 2004, vFinance's wholly-owned subsidiary, vFinance Investments completed its acquisition of certain assets of Global and 100% of the issued and outstanding equity securities of EquityStation, all of which were owned by Level2, a subsidiary of Global. These transactions are subject to the approval of the National Association of Securities Dealers, Inc.

In accordance with the terms of the acquisition agreements, the Company delivered into escrow 8,324,690 restricted shares of the Company's common stock, and warrants to purchase 3,299,728 shares of the Common Stock at a price of \$0.11 per share. All of the shares of EquityStation were also delivered into escrow. Subject to (a) any indemnification claims under the acquisition agreements and (b) the financial performance of EquityStation and the business of Global acquired by vFinance Investments over the periods specified in the escrow agreement, all or a portion of the Shares and the Warrants will be distributed to Global and Level2. As determined pursuant to the financial performance calculation in the escrow agreement, 2,199,425 of the Shares and 871,805 of the Warrants are subject to cancellation in accordance with the terms of the escrow agreement. When the escrow agreement is terminated, all of the shares of EquityStation will be distributed to vFinance Investments, and the holders of the Shares and Warrants will be entitled to certain piggyback registration rights. The Company also entered into a standstill agreement with each of Marcos Konig, Harry Konig and Salomon Konig, to provide restrictions on

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certain actions for a defined time period.

As remuneration for providing advisory services to Global in connection with the acquisitions, Scott J. Saunders ("Saunders") received 150,000 restricted shares of the Common Stock. The shares received by Saunders are not subject to the escrow agreement, registration rights agreement or standstill agreement.

Goodwill was determined as follows; 6,125,265 common shares issued to Global and EquityStation, 150,000 common shares issued to Saunders valued at \$1,192,300 or \$0.19 per share, 2,427,923 warrants valued at \$0.16 per warrant or \$388,468 using the Black-Scholes valuation model, and legal fees in the amount of \$47,863 for a total purchase price of \$1,628,631. The Company acquired net assets of \$181,783 and allocated the difference between the purchase price and the net assets acquired of \$1,446,848 as goodwill.

In accordance with Financial Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation" we have included all vested stock options issued by the Company in exchange for outstanding awards held by employees of the acquired company as part of the purchase price.

The following Pro Forma Combined Financial Statements of Global, EquityStation and vFinance gives effect to the acquisition of certain assets of Global and 100% of the issued and outstanding equity securities of EquityStation, under the purchase method of accounting prescribed by Accounting Principles Board Opinion No. 16, Business Combinations. These pro forma statements are presented for illustrative purposes only. The pro forma adjustments are based upon available information and assumptions that management believes are reasonable.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 3. ACQUISITIONS (CONTINUED)

VFINANCE, INC.  
Pro Forma Combined Statement of Operations  
For the Year Ended December 31, 2004

|                          | vFinance     | Global<br>Partners | EquityStation | Pro Forma<br>Adjustments | Pro Forma     |
|--------------------------|--------------|--------------------|---------------|--------------------------|---------------|
| <b>REVENUE</b>           |              |                    |               |                          |               |
| Commissions              | \$14,571,878 | \$ 186,402         | \$1,764,299   | \$ -                     | \$ 16,522,579 |
| Trading Profits          | 5,156,842    | 2,868,675          | 2,489         | -                        | 8,028,006     |
| Success Fees             | 3,224,973    | -                  | -             | -                        | 3,224,973     |
| Consulting and Retainers | 370,829      | -                  | -             | -                        | 370,829       |
| Other Brokerage Related  |              |                    |               |                          |               |
| Income                   | 2,567,489    | -                  | -             | -                        | 2,567,489     |
| Other Income             | 437,140      | 388,714            | 2             | -                        | 825,856       |
|                          | -----        | -----              | -----         | -----                    | -----         |
|                          | 26,329,151   | 3,443,791          | 1,766,790     | -                        | 31,539,732    |
|                          | =====        | =====              | =====         | =====                    | =====         |
| <b>COST OF REVENUES</b>  |              |                    |               |                          |               |



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|   |              |              |              |       |              |
|---|--------------|--------------|--------------|-------|--------------|
| Commissions                                 | 14,624,914   | 1,675,493    | 456,037      | -     | 16,756,444   |
| Clearing and Transaction Costs              | 1,030,114    | 674,469      | 665,853      | -     | 2,370,436    |
| Success                                     | 1,346,272    | -            | -            | -     | 1,346,272    |
| Consulting and Retainers                    | 224,916      | 2,760        | -            | -     | 227,676      |
| Other                                       | 4,581        | 2,363        | 1,278        | -     | 8,222        |
|   | -----        | -----        | -----        | ----- | -----        |
|   | 17,230,797   | 2,355,085    | 1,123,168    | -     | 20,709,050   |
|   | =====        | =====        | =====        | ===== | =====        |
| GROSS PROFIT                                | 9,098,354    | 1,088,707    | 643,621      | -     | 10,830,682   |
|   | -----        | -----        | -----        | ----- | -----        |
| EXPENSES                                    |              |              |              |       |              |
| General and Administrative                  | 6,686,372    | 1,808,585    | 802,936      | -     | 9,297,893    |
| Professional Fees                           | 157,370      | 6,635        | 260          | -     | 164,265      |
| Provision for Bad Debt                      | 85,567       | -            | -            | -     | 85,567       |
| Legal litigation                            | 399,647      | 94,921       | 18,414       | -     | 512,982      |
| Depreciation and Amortization               | 147,804      | 18,869       | -            | -     | 166,673      |
| Amounts Forgiven under Forgivable Loans     | 80,161       | -            | -            | -     | 80,161       |
| Stock Based Compensation                    | 5,294        | -            | -            | -     | 5,294        |
|   | -----        | -----        | -----        | ----- | -----        |
|   | 7,562,215    | 1,929,010    | 821,610      | -     | 10,312,834   |
|   | -----        | -----        | -----        | ----- | -----        |
| INCOME (LOSS) From Operations               | 1,536,139    | (840,303)    | (177,988)    | -     | 517,848      |
|   | -----        | -----        | -----        | ----- | -----        |
| Gain on Forgiveness of Debt                 | 1,500,000    | -            | -            | -     | 1,500,000    |
| Interest and Dividend Income (Expense)      | (221,704)    | 3,131        | 7,520        | -     | (211,053)    |
|   | -----        | -----        | -----        | ----- | -----        |
| PRE TAX NET INCOME (LOSS)                   | 2,814,435    | (837,172)    | (170,468)    | -     | 1,806,795    |
|   | -----        | -----        | -----        | ----- | -----        |
| Federal Income Tax                          | (40,000)     | -            | -            | -     | (40,000)     |
|   | -----        | -----        | -----        | ----- | -----        |
| NET INCOME (LOSS) Available to Shareholders | \$ 2,774,435 | \$ (837,172) | \$ (170,469) | \$ -  | \$ 1,766,795 |
|   | =====        | =====        | =====        | ===== | =====        |

4. NET CAPITAL REQUIREMENT

Both vFinance Investments and EquityStation are subject to the Securities and Exchange Commission Uniform Net Capital Rule (rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 (and the rule of the "applicable" exchange also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1). At December 31, 2004, vFinance Investments had net capital of \$2,641,131, which was \$1,641,131 in excess of its required net capital of \$1,000,000. EquityStation had net capital of \$271,121 that was \$171,121 in excess of its required net capital of \$100,000.

vFinance Investments' aggregate indebtedness to net capital ratio was to 0.9 to 1 in 2004. Equity Station's aggregate indebtedness to net capital ratio was 0.36

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to 1. vFinance Investments and EquityStation qualify under the exemptive provisions of Rule 15c3-3 under Section (k)(2)(ii) of the Rule, in that they do not carry security accounts of customers or perform custodial functions related to customer securities.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 5. RELATED PARTY TRANSACTIONS

On November 16, 2004, the Company entered into new agreements ("Primary Employment Agreements") to amend and restate certain employment agreements dated November 8, 1999 between the Company's Chief Executive Officer and President, who is the beneficial owner of 15% and 19.7% of the total outstanding common shares of the Company at December 31, 2004 and 2003, respectively, and the Company's Chief Operating Officer and Chairman, who is the beneficial owner of 15% and 19.7% of the total outstanding common shares of the Company at December 31, 2004 and 2003, respectively (collectively the "Primary Shareholders"), as amended on January 5, 2001, July 2, 2001 and January 7, 2002 (the "Previous Employment Agreement"). Under the terms of the Primary Employment Agreements, which shall be for a three year period and shall automatically extend for a one year period on each anniversary date thereafter unless the Company has provided a non-renewal notice thirty (30) days prior to an anniversary date as directed by a majority vote of the board of directors, each individual shall receive (i) an initial base salary of \$257,000 per annum which shall increase 5% per annum beginning January 1, 2005 and each year thereafter and will be reviewed by the Board at least annually and may be increased (but not decreased) from time to time as Board may determine; (ii) discretionary bonuses and/or interim cash bonuses and/or other bonuses when and in such amounts as may be determined by the Company's board of directors based on each individuals performance, the Company's performance and/or other factors; provided that the Board shall meet at least annually to review employees' bonus entitlements; and (iii) incentive compensation paid quarterly no later than the 45th day following the end of quarter primarily based on performance of the Company and its respective subsidiaries. The Primary Employment Agreements also contain provisions related to change of control.

On December 2002, each of the Primary Shareholders forfeited a total of 734,802 outstanding options by signing an Options Cancellation Agreement. Accordingly, at December 31, 2002 there were no stock options held by the Primary Shareholders. On July 1, 2003, the Company granted the Primary Shareholders a total of 734,802 options at a price of \$0.21.

On January 1, 2003, the Company entered into a Joint Venture Agreement with JSM Capital Holding Corp. ("JSM"), a retail brokerage operations headquartered in New York and founded by John S. Matthews. The Company issued JSM 1,000,000 warrants to purchase its common stock at an exercise price of \$0.20 in exchange for a 19% equity position in JSM. The warrants were valued using the Black-Scholes valuation method which calculated the value to be \$0.08 per warrant, or \$80,000. The Company accounts for this investment using the cost method. Effective May 1, 2003, vFinance merged its "company-owned" retail branches into JSM. Effective upon such merger JSM became an independent contractor of the Company.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

6. INCOME TAXES

The components of the Company's tax provision for the years ended December 31, 2004 and 2003 were as follows:

|                               | Year Ended December 31, 2004 |      |
|-------------------------------|------------------------------|------|
|                               | 2004                         | 2003 |
| Current income tax expense    | \$ 40,000                    | \$ - |
| Deferred income tax (benefit) | (40,000)                     | -    |
|                               | \$ -                         | \$ - |

Deferred income taxes reflect the net income tax effect of temporary differences between the carrying amounts of the assets and liabilities for financial reporting purposes and amounts used for income taxes. The Company's deferred income tax assets and liabilities consist of the following:

|   | Year Ended December 31, 2004 |           |
|---|------------------------------|-----------|
|   | 2004                         | 2003      |
| Net operating loss carryforwards              | \$ 3,282,787                 | \$ 4,250, |
| Unrealized losses                             | 65,809                       | 45,       |
| Goodwill impairment                           | -                            | 2,775,    |
| Allowance for doubtful accounts               | 2,319                        | 74,       |
| Depreciation                                  | 11,573                       | (6,       |
| Gross deferred income tax assets              | 3,362,488                    | 7,140,    |
| Deferred income tax asset valuation allowance | (3,322,488)                  | (7,140,   |
| Net deferred income tax assets                | \$ 40,000                    | \$        |

Net operating loss carryforwards totaled approximately \$8,575,000 at December 31, 2004. The net operating loss carryforwards will begin to expire in the year 2021 if not utilized. After consideration of all the evidence, both positive and negative, management has recorded a valuation allowance at December 31, 2004 and

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2003, due to the uncertainty of realizing the deferred tax assets.

The company was subject to an approximate \$40,000 alternative minimum tax for the tax year ending December 31, 2004. Such amount may be carried forward as a tax credit to offset regular tax in future years.

The reconciliation of the income tax computed at the U.S. Federal statutory rate to income tax expense for the period ended December 31, 2004 and 2003:

|   | Year Ended December 31, 2004 |        |
|---|------------------------------|--------|
|   | 2004                         | 2003   |
| Tax expense (benefit) at federal rate (35%) | \$ 971,052                   | \$ 106 |
| Nondeductible expenses                      | 2,806,786                    | (116)  |
| Alternative Minimum Tax                     | 40,000                       |        |
| Change in valuation allowance               | (3,817,838)                  | 10     |
|   | -                            | -      |
| Net income tax (benefit) allowance          | \$ -                         | \$ -   |

Utilization of the Company's net operating loss carryforwards are limited based on changes in ownership as defined in Internal Revenue Code Section 382.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 7. SHAREHOLDERS' EQUITY

The Company is authorized to issue up to 2,500,000 shares of Preferred Stock. 122,500 shares were designated as Series A Convertible Preferred Stock, par value \$0.01 per share, and 50,000 shares were designated as Series B Convertible Preferred Stock, par value \$0.01 per share. As of December 31, 2004 there are no Preferred Stock outstanding.

Series A and B Preferred Stock had the following rights, preferences, privileges and restrictions:

**LIQUIDATION PREFERENCE.** In the event of any liquidation or winding up of the Company, the holders of the Series A and B Preferred Stock were entitled to receive, in preference to the holders of Common Stock, an amount equal to \$10 per share, plus unpaid dividends, if any. A consolidation or merger would have been deemed a liquidation or winding up for purposes of the liquidation

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preference.

**DIVIDEND RIGHTS.** The holders of Series A and B Preferred Stock were entitled to receive cumulative dividends in preference to holders of Common Stock at the rate of \$1 and \$0.70 per share annum (10% and 7% of the liquidation preference price) for Series A and B, respectively, whether or not earned or declared.

**CONVERSION PRICE ADJUSTMENTS.** The conversion price of the Series A and B Preferred Stock were subject to adjustments to prevent dilution, on the weighted average basis, in the event the Company issued additional shares, at a purchase price of \$2.60 per share.

**VOTING RIGHTS.** The holders of Series A and B Preferred Stock had no voting rights.

**REDEMPTION RIGHTS.** The Company, at its option, could have redeemed, in whole or in part, the shares of Series A and B Preferred Stock outstanding, at any time, upon notice given, at a redemption price of \$11 and \$10 per share, respectively. If the Company received proceeds from a single sale of its equity securities of at least \$500,000, the holders of Series A and B Preferred Stock could have required the Company to redeem all, but not less than all, the Series B Preferred Stock at a redemption price equal to \$10 per share.

On November 28, 2001, we entered into a Note Purchase Agreement, as amended on November 30, December 14 and December 28, 2001 and February 13 and March 4, 2002 (collectively, the "Agreement"), with SBI Investments (USA) Inc. ("SBI"). Under the terms of the Agreement, SBI provided a loan to us in the amount of \$975,000 in the form of a 48-month non-interest bearing, convertible note (the SBI Note). The SBI Note is convertible at SBI's option into as many as 3,421,052 shares of our common stock at \$0.285 per share.

In accordance with EITF Issue No. 00-27, (APPLICATION OF ISSUE NO. 98-5), ACCOUNTING FOR CONVERTIBLE SECURITIES WITH BENEFICIAL CONVERSION FEATURES OF CONTINGENTLY ADJUSTABLE CONVERSION RATIOS, IN CERTAIN CONVERTIBLE INSTRUMENTS, and APB # 21 (INTEREST ON RECEIVABLES AND PAYABLES) the Company recorded an imputed interest factor related to the Note Purchase Agreement of \$563,000. The Company fully expensed the beneficial conversion factor due to the fact that the SBI Note was immediately convertible. The net one time charge to the financial statements was \$412,000.

The imputed interest was accreted ratably over the term of the loan as additional interest expense. Amortization of the imputed interest began in January 2002.

During year 2002, the SBI Note was reduced by \$225,000 as a portion of the SBI Note was converted into 789,474 shares of the Company's common stock.

As of December 31, 2003 the SBI note payable balance was \$750,000 and was netted against the \$146,787 corresponding asset imputed interest.

During February and March of 2004, \$721,500 of the SBI Note was converted into 3,344,298 shares of the Company's common stock. Of this amount, \$545,000 was converted into 2,725,000 shares of the Company's common stock at a discounted rate of \$0.20 per share under a special arrangement offered by the Company to encourage further equity participation by SBI, which resulted in a \$231,625 conversion premium expense during the first quarter of 2004. The remainder, \$176,500, was converted into 619,298 shares at the stated conversion rate of \$0.285 per share. In April of 2004, the remaining balance was converted into 100,000 shares of common stock of the Company at the original stated conversion rate of \$.285 per share. The issuance of the common stock was exempt from registration pursuant to Section 4 (2) of the Securities Act of 1933, as amended, because the common stock was acquired in a privately negotiated

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transaction by sophisticated investors. Accordingly, the balance due SBI at December 31, 2003 was \$750,000 and 2004 was \$0.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 7. SHAREHOLDERS' EQUITY (CONTINUED)

On February 27, 2003, the Company entered into an agreement whereby Arend Verweij and Hoss Bozorgzad, independent contractors of the Company, purchased 1,500,000 unregistered common shares at a price of \$0.0867 for a total consideration of \$130,000.

The above noted securities issued to the investors were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, and Rule 506 of Regulation D promulgated thereunder because the securities were acquired in a privately negotiated transaction by sophisticated investors.

During the first quarter of 2004, the Company granted stock options to purchase an aggregate of 1,625,000 shares of the Company's common stock to certain employees of the Company. The exercise prices of these options range from \$.20 to \$.28. During the second quarter of 2004, the Company granted stock options to purchase an aggregate of 105,000 shares of the Company's common stock to two employees of the Company. The exercise price of these options was \$0.35. During the third quarter of 2004, the Company granted stock options to purchase an aggregate of 205,000 shares of the Company's common stock to certain employees of the Company. The exercise prices of these options range from \$0.19 to \$0.36. During the fourth quarter of 2004, the Company granted stock options to purchase an aggregate of 2,202,502 shares of the Company's common stock to certain employees of the Company. The exercise prices of these options range from \$0.19 to \$0.28. The option grants were exempt from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, because the individuals receiving the options are sophisticated investors who have knowledge of all material information about the Company.

A summary of the stock option activity for the years ended December 31, 2004 and 2003 is as follows:

|  | Exercise Price | Weighted Average<br>Number of Shares | Exercise Price Per Option |
|--|----------------|--------------------------------------|---------------------------|
|  | -----          | -----                                | -----                     |
| Outstanding Options at December 31, 2002 | 0.50           | 4,471,664                            | 0.15 - 6.00               |
| Granted                                  | 0.20           | 7,635,349                            | 0.15 - 0.22               |
| Forfeited                                | 0.49           | (1,760,802)                          | 0.21 - 4.13               |
|  |                | -----                                |                           |
| Outstanding Options at December 31, 2003 | 0.29           | 10,346,211                           | 0.15 - 6.00               |
| Granted                                  | 0.21           | 4,137,502                            | 0.19 - 0.36               |
| Forfeited                                | 0.23           | (3,945,500)                          | 0.15 - 0.35               |
|  |                | -----                                |                           |

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Outstanding Options at December 31, 2004      0.28      10,538,213      0.15 - 2.25  
 =====

The following table summarizes information concerning stock options outstanding at December 31, 2004

| Weighted<br>Average<br>Exercise<br>Price<br>----- | Number<br>Outstanding<br>----- |
|---|--------------------------------|
| \$0.15  | 350,000                        |
| 0.19  | 1,860,002                      |
| 0.20  | 1,280,000                      |
| 0.21  | 3,700,497                      |
| 0.22  | 50,000                         |
| 0.23  | 2,500                          |
| 0.25  | 5,000                          |
| 0.28  | 200,000                        |
| 0.32  | 890,000                        |
| 0.35  | 1,554,215                      |
| 0.36  | 120,000                        |
| 0.50  | 100,000                        |
| 0.55  | 69,000                         |
| 0.63  | 142,500                        |
| 0.70  | 39,000                         |
| 1.00  | 18,000                         |
| 2.25  | 157,499                        |
|   | -----                          |
|   | 10,538,213                     |
|   | =====                          |

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

7. SHAREHOLDERS' EQUITY (CONTINUED)

A summary of the warrant activity for the years ended December 31, 2004 and 2003 is as follows:

|   | Weighted<br>Average<br>Exercise<br>Price<br>----- | Number of<br>Shares<br>----- | Exercise Price<br>Per Option<br>----- |
|---|---|------------------------------|---------------------------------------|
| Outstanding Warrants at December 31, 2002 | 2.15  | 4,108,499                    | 0.35 - 7.20                           |
| Granted                                   | 0.25  | 1,290,000                    | 0.15 - 2.25                           |
|   |   | -----                        |                                       |

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|   |      |           |             |
|---|------|-----------|-------------|
| Outstanding Warrants at December 31, 2003 | 1.70 | 5,398,499 | 0.35 - 7.20 |
| Granted                                   | 0.16 | 2,927,923 | 0.15 - 0.16 |
| Forfeited                                 | 0.44 | (230,000) | 0.35 - 2.50 |
|   |      | -----     |             |
| Outstanding Warrants at December 31, 2004 | 1.18 | 8,096,422 | 0.15 - 7.20 |
|   |      | =====     |             |

The following table summarizes information concerning warrants outstanding at December 31, 2004.

| Weighted<br>Average<br>Exercise<br>Price | Number<br>Outstanding |
|--|-----------------------|
| -----                                    | -----                 |
| 0.15                                     | 750,000               |
| 0.26                                     | 2,427,923             |
| 0.20                                     | 1,000,000             |
| 0.35                                     | 1,773,500             |
| 0.63                                     | 400,000               |
| 2.25                                     | 625,000               |
| 2.50                                     | 290,000               |
| 6.00                                     | 129,999               |
| 7.20                                     | 700,000               |
|  | -----                 |
|  | 8,096,422             |
|  | =====                 |

The weighted average grant-date fair value of warrants granted equaled \$0.16 and \$0.25 for the years ended December 31, 2004 and 2003, respectively. The weighted average grant-date fair value of options granted during the year equaled \$0.21 and \$0.20 for the years ended December 31, 2004 and 2003, respectively. For purposes of pro forma disclosures, the estimated fair value of the options and warrants is amortized to expense over their respective vesting periods.

Options granted to employees are exercisable according to the terms of each agreement, ranging from one month to four years. At December 31, 2004 and 2003, 5,779,766 and 4,916,608 options outstanding were exercisable with weighted average exercise prices of \$.35 and \$.37, respectively. At December 31, 2004 and 2003, 7,920,172 and 4,745,999 warrants outstanding were exercisable with weighted average exercises prices of \$1.15 and \$1.75, respectively.

Pro forma information regarding net income (loss) is required by SFAS 123, which also requires that the information be determined as if the Company has accounted for its employee stock options under the fair value method. The fair value for options and warrants granted was estimated at the date of grant using the Black Scholes option pricing model with the following weighted-average assumptions: for 2004 risk-free interest rates of 3.31%; no dividend yields; volatility factor of the expected market price of the Company's common stock of 1.12 for options and warrants and an expected life of the options and warrants of 4-5 years; for 2003: risk-free interest of 3.28%; no dividend yields; volatility factor of the expected market price of the Company's common stock of 2.131; and an expected life of the options and warrants of 4-5 years. The Company's pro forma net income for the year ended December 31, 2004 is \$2,287,230 and the pro forma net loss for the year ended December 31, 2003 is \$128,971. The Company's pro forma basic and diluted net income per share for the year ended December 31, 2004 is \$0.07 and \$0.06, respectively. Pro forma basic net loss per share for the year ended December 31, 2003 is \$0.00.



vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

#### 7. SHAREHOLDERS' EQUITY (CONTINUED)

The Company recorded deferred compensation of \$5,294 and \$17,714 during the years ended December 31, 2004 and 2003, respectively, in connection with the grants of stock options, primarily to outside consultants, with exercise prices lower than the deemed fair value per share of the Company's common stock on the date of the grants. The Company had an unamortized balance of \$ 12,420 at December 31, 2002 fully amortized during 2003. In addition, during 2003 the Company granted 250,000 warrants, valued at \$30,000, to its landlord in relation to the renegotiation of the lease on its headquarters. This balance is being amortized over the term of the lease. At December 31, 2004 the remaining unamortized balance was \$19,409.

#### 8. DEBT

On January 25, 2002, the Company entered into a Credit Agreement, as amended on April 12, 2002, with UBS Americas, Inc. ("UBS"). Under the terms of the Credit Agreement, UBS provided the Company with a revolving credit facility for up to \$3,000,000 for the purpose of supporting the expansion of our brokerage business or investments in infrastructure to expand our operations and our broker-dealer operations. The loan had a term of 4 years, was required to be repaid in full by January 2005, and accrued interest at LIBOR plus a LIBOR margin of 2% if the loan was repaid within a month or 5% if it was outstanding more than a month. The Company borrowed \$1,500,000 under the credit facility on January 28, 2002 leaving an additional \$1,500,000 available. In June 2003, Fidelity Investments, on behalf of its clearing division, National Financial Services LLC, Member NYSE/SIPC, a Fidelity Investments company ("NFS"), announced that it had acquired Correspondent Services Clearing ("CSC"), an affiliate of UBS and vFinance Investments' clearing firm at the time. The credit facility stayed with UBS subsequent to the acquisition giving rise to potential breaches under such credit facility as well as precluding the Company from drawing an additional \$1,500,000 thereunder. During March 2004, NFS agreed to directly pay down the UBS credit facility in the amount of \$1,500,000 pursuant to a guaranty Fidelity Investments made to UBS as part of their original acquisition of the CSC clearing division. As a result, the Company was relieved from \$1,500,000 in debt but no longer had the ability to obtain an additional \$1,500,000 under the credit facility or assert any claims against UBS or NFS regarding this transaction and credit facility. During March 2004, the Company entered into a clearing agreement with NFS. The new clearing agreement required NFS to pay to vFinance, over a five year period beginning January 2004, a monthly incentive bonus not to exceed \$25,000 per month up to \$1,500,000, based on a formula that the Company believes is very achievable. Accordingly, NFS has been paying \$25,000 per month related to this incentive calculation and such amount, \$300,000 through December 31, 2004, has been included in the attached statements of operations as "other brokerage related income". The new clearing agreement also required NFS to provide the Company with \$200,000 to assist the company with transition costs related to the conversion from CSC to NFS. This amount was paid to vFinance in March 2004 and was included in the first quarter's statements of operations as a reduction to clearing and transaction costs. In

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consideration for these incentives, NFS required a termination fee of \$1,700,000 should vFinance discontinue using NFS' services. This fee is reduced, pro rata, annually over the five year term of the agreement. The Company began clearing through NFS during May 2004.

As discussed in Note 7, the Company entered in to a Note Purchase Agreement with SBI Investments (USA), Inc. ("SBI"). As of December 31, 2003 the SBI note payable balance was \$750,000. During 2004, the balance of the Note was converted into 3,444,298 shares of the Company's common stock. Of this amount, \$545,000 was converted into 2,725,000 shares of the Company's common stock at a discounted rate of \$0.20 per share under a special arrangement offered by the Company to encourage further equity participation by SBI, which resulted in a \$231,625 conversion premium expense during the first quarter of 2004. Accordingly, the balance due SBI at December 31, 2003 was \$750,000 and 2004 was \$0.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 9. COMMITMENTS AND CONTINGENCIES

The Company leases office space under the terms of operating leases. The following chart shows lease obligations including rental of real property and equipment.

| YEAR  | AMOUNT      |
|-------|-------------|
| 2005  | \$ 828,484  |
| 2006  | 797,233     |
| 2007  | 764,543     |
| 2008  | 599,654     |
| 2009  | 85,897      |
|       | -----       |
| TOTAL | \$3,075,811 |
|       | =====       |

Total rent expense under operating leases, including space rental, totaled \$690,415 and \$700,464 for the years ended December 31, 2004 and 2003.

Capital lease obligations at December 31, 2004 consisted of the following:

|                                | 2004       |
|--------------------------------|------------|
|                                | -----      |
| Obligation under capital lease | \$ 188,303 |
| Less current maturities        | (65,355)   |
|                                | -----      |
|                                | \$ 122,948 |

=====

Future minimum lease payments for equipment under capital leases at December 31, 2004 are as follows:

|                                    |    |          |
|------------------------------------|----|----------|
| 2005                               | \$ | 74,417   |
| 2006                               |    | 74,417   |
| 2007                               |    | 55,049   |
|                                    |    | -----    |
| Total minimum lease payments       |    | 203,883  |
| Less amount representing interest  |    | (15,580) |
|                                    |    | -----    |
| Present value of net minimum lease |    | 188,303  |
| Less current portion               |    | (65,355) |
|                                    |    | -----    |
|                                    | \$ | 122,948  |
|                                    |    | =====    |

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

9. COMMITMENTS AND CONTINGENCIES (CONTINUED)

From time to time the Company, and/or one of its subsidiaries, is named as a party to a lawsuit that has arisen in the ordinary course of business. Although it is possible that losses exceeding amounts already recorded may be incurred upon ultimate resolution of these existing legal proceedings, we believe that such losses, if any, will not have a material adverse effect on our business, results of operations or financial position; however, unfavorable resolution of each matter individually or in the aggregate could affect the consolidated results of operations for the quarterly and annual periods in which they are resolved.

The business of vFinance Investments and EquityStation involve substantial risks of liability, including exposure to liability under federal and state securities laws in connection with the underwriting or distribution of securities and claims by dissatisfied customers for fraud, unauthorized trading, churning, mismanagement and breach of fiduciary duty. In recent years, there has been an increasing incidence of litigation involving the securities industry, including class actions that generally seek rescission and substantial damages.

In the ordinary course of business, the Company and/or its subsidiaries may be parties to other legal proceedings and regulatory inquiries, the outcome of which, either singularly or in the aggregate, is not expected to be material. There can be no assurance however that any sanctions will not have a material adverse effect on the financial condition or results of operations of the Company and/or its subsidiaries. The following is a brief summary of certain matters pending against or involving the Company and its subsidiaries.

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On August 20, 2001, we entered into a Securities Exchange Agreement by means of which we acquired the membership interests in two related companies, Critical Investments, LLC, a Delaware limited liability company ("Critical Investments"), and Critical Advisors, L.L.C., a Virginia limited liability company ("Critical Advisors"). Critical Investments manages Critical Infrastructure Fund, L.P. ("Critical Infrastructure LP"), a Delaware limited partnership. Critical Advisors manages Critical Infrastructure Fund, Ltd. ("Critical Infrastructure Ltd."), an international business company organized and existing under the laws of the British Virgin Islands and receives (i) a management fee equal to 1% of the net asset value of Critical Infrastructure Ltd. and (ii) a performance fee equal to 20% of the increase in net asset value of Critical Infrastructure Ltd. Critical Infrastructure LP and Critical Infrastructure Ltd. are the sole general partners in, owning 96% and 4%, respectively, and conduct their investment and trading activity through Critical Infrastructure Fund (BVI), LP, a limited partnership organized and existing under the laws of the British Virgin Islands, which holds a portfolio of securities. A determination has been made to liquidate the funds. The SEC is conducting a non-public investigation relating to Critical Infrastructure LP, Critical Investments and Critical Advisors. The Company is cooperating with this investigation. Critical Investments and Critical Advisors changed their names to vFinance Investors, LLC and vFinance Advisors, LLC, respectively, subsequent to the acquisition.

On August 14, 2002, Henry S. Snow and Sandra L. Snow filed a complaint against Colonial Direct and vFinance, Inc. in the Circuit Court of the 15th Judicial Circuit in Palm Beach County, Florida. The claim alleges "Breach of Contract" and "Unjust Enrichment" and seeks damages of \$250,000 plus interest and court costs. It is alleged that Colonial Direct defaulted on a Promissory Note in the principal amount of \$250,000. The Company believes their claim is without merit and is vigorously defending the action.

On October 23, 2002, Henry Shoemaker, III, filed a claim with the NASD against First Level Securities, now known as vFinance Investments, Inc., stating among other things, that there was a breach of fiduciary duties resulting in a loss of \$570,000. This matter went to the arbitration panel during 2004 and Mr. Shoemaker was awarded \$15,000. Mr. Shoemaker filed an action in the Parish of Orleans requesting that the arbitration be vacated. vFinance Investments filed a motion to remove the matter to Federal Court. Federal Court denied his request to vacate the arbitration. Mr. Shoemaker then appealed to Federal Courts ruling to the United States Court of Appeal for the 5th Circuit. This matter is still pending.

On January 12, 2003, MP 830 Third Avenue LLC ( the Landlord), filed a claim against First Colonial, vFinance, Inc. and vFinance Investments Inc. in the Supreme Court of the State of New York, alleging the abandonment of leased facilities and seeking payment of the related rent. The lease was for a term of seven years expiring on December 31, 2006. First Colonial allegedly ceased paying rent as of July 1, 2002. After applying First Colonial's security deposit of \$200,000, the Landlord is seeking \$59,868 plus any further rent due until such time as they can successfully lease the premises at a similar rate. This matter was settled on December 6, 2004 in the amount of \$100,000.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

9. COMMITMENTS AND CONTINGENCIES (CONTINUED)

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On April 15, 2003, Ms. Madeline Moore filed a claim with the NASD against vFinance Investments, Inc. in the amount of \$150,527 claiming a breach of fiduciary duties. This matter was settled on February 27, 2004 in the amount of \$125,000.

On October 17, 2003, we were advised by the staff of the SEC that it intended to recommend that the SEC institute enforcement proceedings against vFinance Investments and one of its former employees. The SEC claims that vFinance Investments and its former employee failed reasonably to supervise the alleged illegal trading activities over a period of approximately two months of one of our broker/dealer's former securities traders with respect to one publicly traded security that resulted in vFinance Investments earning \$11,000 in commissions related to that one security over the two month period. As of December 31, 2004, the Company has included an accrual of \$50,000 for estimated expenses. On March 17, 2005 we were advised by a member of the staff of the SEC that the SEC had accepted our offer to settle the matter. Pursuant to the terms of the settlement, vFinance Investments is required to make its first payment of the \$50,000 penalty (\$16,667) within 30 days of the entry of the Order. In addition, the Company will need to retain, within 60 days of the date of the Order, an independent consultant to conduct a review of vFinance's existing procedures regarding the supervision of traders to ensure that they are adequate. The Company believes that this matter will not have a material adverse affect on its business and operations.

On November 13, 2003, UBUY Holdings, Inc., f/k/a E-PAWN.COM, Inc., and Steven Bazuly, and for and on behalf of all of the shareholders of UBUY Holdings, Inc. filed an amended complaint for damages and consequential damages against vFinance Investments, Inc. and approximately 60 other defendants in the United States District Court for the Southern District of Florida stating, among other things, that there were violations of certain securities rules and regulations. The Company has not yet been served with this complaint, but in the event it is, the Company believes that their claim is without merit and will vigorously defend this action.

On March 15, 2004 Joseph & Joan Barr filed a claim with the NASD against Pittsford Capital Markets, vFinance Investments, Inc. and others, claiming that vFinance Investments was the successor firm to Pittsford Capital Markets and alleging, among other things, that in 1998 he purchased Private Placements that were unsuitable. The claim alleges damages of \$700,000. The Company believes their claim is without merit and is vigorously defending the action.

On or about February 28, 2005, Knight Equity Markets, L.P. ("Knight") commenced an arbitration proceeding with the National Association of Securities Dealers Inc. by filing a Statement of Claim against vFinance Investments, Inc., and one of vFinance's registered representatives, Steven Soskin. The matter is titled Knight Equity Markets, L.P. v. vFinance Investments, Inc., and Steven Soskin, NASD Case No. 05-01069. Knight alleges that vFinance and Mr. Soskin were engaged in a fraudulent scheme to buy various stocks at ex-dividend prices that vFinance and Mr. Soskin knew were subject to dividends. Knight further alleges that vFinance received \$6.5 million in dividends that it was not otherwise entitled to receive. Knight seeks a declaration that vFinance was not entitled to receive the dividends, \$6.5 million in damages, attorneys fees, costs and an unspecified amount of punitive damages. The matter is currently in the pleadings phase. . The primary customer involved in the subject stock purchases has now filed an action in the Supreme Court for the State of New York against Knight seeking a Declaratory Judgment and Equitable Relief with regard to the subject dividends. This action seeks a declaratory judgment that the customer is the rightful owner of the \$5.8 million in dividends. The Company believes that Knight's claim is without merit, and the Company will vigorously defend the action.

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We are engaged in a number of other legal proceedings incidental to the conduct of our business. These claims aggregate a range of \$28,000 to \$260,000.

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vFinance, Inc.

Notes to Consolidated Financial Statements (continued)

### 10. DEFINED CONTRIBUTION PLAN

The Company maintains a defined contribution savings plan in which substantially all employees are eligible to participate. The Company may match up to 25% of the employee's salary. The Company made no contributions to the plan for the years ended December 31, 2004 and 2003, respectively.

### 11. SUBSEQUENT EVENTS

Subsequent to December 31, 2004, the Company came to an agreement in principle with The Center for Innovative Entrepreneurship ("CIE"), a nonprofit organization, to develop [www.vfinance.com](http://www.vfinance.com) as a platform for academic-quality research on entrepreneurial activities and to produce the Company's proprietary vFinance Entrepreneurial Confidence Index ("VECI") and sector research reports, and to provide educational and informational services to entrepreneurs with start-ups and other early-stage firms. The Company also agreed to enter into a management services agreement to provide management, administrative and technical support services for CIE. It is anticipated that the Company and CIE will enter into definitive documentation evidencing these agreements in April 2005.

On January 31, 2005, The Company issued 300,000 common shares in connection with the exercise of options. The Company received \$60,000. The exercise price of these options was \$0.20.

On March 14, 2005, The Company issued 255,000 common shares in connection with the exercise of options. The Company received \$53,550. The exercise price of these options was \$0.21.

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### ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

### ITEM 8A. CONTROLS AND PROCEDURES.

Our Chief Executive Officer and Chief Financial Officer (collectively, the "Certifying Officers") are responsible for establishing and maintaining

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disclosure controls and procedures for us. Such officers have concluded (based upon such officers' evaluation of these controls and procedures as of the end of the period covered by this report) that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in this report is accumulated and communicated to management, including our principal executive officers as appropriate, to allow timely decisions regarding required disclosure.

The Certifying Officers have also indicated that there were no significant changes in our internal controls or other factors that could significantly affect such controls subsequent to the date of their evaluation, and there were no corrective actions with regard to significant deficiencies and material weaknesses.

Our management, including each of the Certifying Officers, does not expect that our disclosure controls or our internal controls will prevent all error and fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control. The design of any systems of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### ITEM 8B. OTHER INFORMATION.

On November 16, 2004, we amended and restated employment agreements with our Chief Executive Officer and President and our Chief Operating Officer and Chairman. The new employment agreements provide for a three year term with automatic one year extensions unless we provide notice of non-renewal thirty days prior to the anniversary date. The new employment agreements also provide for initial base salaries of \$257,000 per annum, which shall increase 5% per annum beginning January 1, 2005, subject to periodic reviews by the Board of Directors; discretionary bonuses, cash bonuses and other bonuses as may be determined by the Board of Directors based on the Company's performance, the individual's performance, and other factors; and incentive compensation paid quarterly based on the Company's performance. The new agreements also contain provisions related to change of control.

On January 12, 2005, the Company entered into an employment letter agreement with Kathleen Kennedy to serve in the capacity of Executive Vice President, Corporate Marketing of vFinance, Inc. Under the terms of this Agreement, Ms. Kennedy will receive a base salary of \$140,000 and annual incentive compensation based on achievement of the Company's overall revenue, margin and profit objectives. Ms. Kennedy's agreement also provided for her to provide services as Executive Director for CIE and a portion of her incentive compensation is based on her ability to accomplish certain income objectives for CIE. The letter agreement includes an award of stock options subject to a specified vesting period and also provides severance benefits upon change of control and upon the occurrence of certain events.

## PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS;  
COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.

The following table sets forth the names, ages and positions of our executive officers and directors as of March 28, 2005. Under our bylaws, each director holds office until the election and qualification of his successor or until his earlier resignation or removal.

| Name                | Age | Position  |
|---------------------|-----|---|
| ----                | --- | -----   |
| Leonard J. Sokolow  | 48  | Director, Chief Executive Officer<br>and President          |
| Timothy E. Mahoney  | 48  | Director, Chief Operating Officer<br>and Chairman           |
| Sheila C. Reinken   | 44  | Chief Financial Officer and Chief<br>Administrative Officer |
| Richard Campanella  | 54  | Secretary   |
| Kathleen J. Kennedy | 51  | Executive Vice President, Corporate<br>Marketing            |

LEONARD J. SOKOLOW has been a director since November 8, 1997, our Chief Executive Officer since November 8, 1999, and our President since January 5, 2001. From November 8, 1999 through January 4, 2001, Mr. Sokolow was Vice Chairman of the Board. Since September 1996, Mr. Sokolow has been President of Union Atlantic LC, a merchant, banking and strategic consulting firm specializing domestically and internationally in technology industries that is a wholly-owned subsidiary of our company. Since August 1993, Mr. Sokolow has been President of Genesis Partners, Inc., a private financial business-consulting firm. Genesis Partners, Inc. has been inactive since December 31, 2002. From August 1994 through December 1998, Mr. Sokolow was the Chairman and Chief Executive Officer of the Americas Growth Fund, Inc., a public closed-end management investment company. Mr. Sokolow presently serves as a director of AESP, Inc., a worldwide distributor and manufacturer of active and passive networking components traded on the OTC BB. Mr. Sokolow received a B.A. degree with majors in Economics and Accounting from the University of Florida in 1977, a J.D. degree from the University of Florida School of Law in 1980 and an LL.M. (Taxation) degree from the New York University Graduate School of Law in 1982. Mr. Sokolow is a Certified Public Accountant.

TIMOTHY E. MAHONEY has been a director since November 8, 1999 and since November 8, 1999, Chairman of the Board and our Chief Operating Officer. Since September 1996, Mr. Mahoney has been a partner of Union Atlantic LC. From 1994 through 1995, Mr. Mahoney was President of the Highlands Group. Mr. Mahoney was a founder of the consumer products business for SyQuest Technology. In 1986, Mr. Mahoney founded and was the President of Rodime Systems, a computer disk drive sub-system manufacturer. In addition, Mr. Mahoney was the Vice President of



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Marketing and Sales for Tecmar, the first PC add-in board company and spent eight years in marketing and sales management in the computer timesharing business with Computer Sciences Corporation, Automatic Data Processing and General Electric Information Services. Mr. Mahoney presently serves as a director of FOCUS Enhancements, Inc., a developer and marketer of advanced, proprietary video scan conversion products traded on the Nasdaq SmallCap market. Mr. Mahoney received a B.A. degree with majors in Computer Science and Business from the West Virginia University in 1978. Mr. Mahoney received a Master of Business Administration from George Washington University in 1983.

SHEILA C. REINKEN has been the CFO of the Company since January 2005. Ms. Reinken was vice president, finance for Burger King Corporation from March 2002 through November 2004. Prior to that Ms. Reinken was vice president, finance for American Eagle Outfitters and from January 2001 until February 2002. Prior to that Ms. Reinken was vice president, treasurer of Ames Department Stores, Inc. from August 1999 until January 2001. She holds a Master of Business Administration from Florida Atlantic University and a Bachelor of Science degree from Florida State University.

RICHARD CAMPANELLA has been Secretary of the Company since December 18, 2001. Mr. Campanella currently serves as the Chief Operating Officer of vFinance Investments, Inc. From February 1994 until April 2001, Mr. Campanella was a partner of Commonwealth Associates, a registered broker dealer where he served as the Director of Compliance. He has a degree in Business Administration from the College of Staten Island.

KATHLEEN J. KENNEDY has been EVP Corporate Marketing since January 19, 2005. Prior to joining the Company, Ms. Kennedy held executive marketing and strategy positions, including, Vice President, Marketing/Customer Development for Office Depot, Inc. from July 2001 through November 2004, Senior Vice President of Marketing for Infousa, Inc. from July 2000 until January 2001, and Vice President Marketing for OfficeMax, Inc. from May 1999 until July 2000. Ms. Kennedy also served as Group Director/Managing Partner with OgilvyOne, a division of WPP Group plc., from May 1997 until May 1999. She has a Master of Business Administration from University of Miami and a Bachelor of Arts from University of Delaware.

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### AUDIT COMMITTEE

The Company's board of directors serves as the audit committee. Leonard J. Sokolow has been designated as an "audit committee financial expert" as such term is defined in the SEC's rules.

### CODE OF ETHICS

The Company has adopted a Code of Ethics for the Chief Executive Officer and Chief Financial Officer, which was filed as Exhibit 14 to the Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003, and is herein incorporated by reference. If the Company makes any substantive amendments to its code of ethics or grants any waiver, including any implicit waiver, from a provision of the code to the Chief Executive Officer or Chief Financial Officer, the Company will disclose the nature of such amendment or waiver in a report on Form 8-K.

### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who beneficially own more than ten percent (10%) of a registered

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class of our company's equity securities, to file with the Securities and Exchange Commission (SEC) initial reports of ownership and reports of changes in ownership of Common Stock and the other equity securities of the Company. Officers, directors and persons who beneficially own more than ten percent (10%) of a registered class of our company's equity securities are required by the regulations of the SEC to furnish the Company with copies of all Section 16(a) forms they file.

To our knowledge, based solely on review of these filings and written representations from the directors and officers, we believe that during the fiscal year ended December 31, 2004, our officers, directors and significant stockholders have timely filed the appropriate form under Section 16(a) of the Exchange Act, except a Form 4 for Sheila C. Reinken (one filing).

### ITEM 10. EXECUTIVE COMPENSATION.

The following table provides information concerning the annual and long term compensation earned by our chief executive officer and each of the other most highly compensated executive officers of the Company (collectively, the "Named Executive Officers") during the fiscal years ended December 31, 2004, 2003 and 2002:

SUMMARY COMPENSATION TABLE

| Name/Position<br>-----  | Year<br>---- | Annual<br>----- |                |                                | Long-Term<br>Compensation<br>-----           |
|---|--------------|-----------------|----------------|--------------------------------|--|
|   |              | Salary<br>----- | Bonus<br>----- | Other<br>Compensation<br>----- | Securities<br>Underlying<br>Options<br>----- |
| Leonard J. Sokolow<br>CEO, President (1) (2) (3)                            | 2004         | \$236,265       | \$180,000      | \$0                            | 0  |
|   | 2003         | \$230,265       | \$0            | 18,900                         | 734,802 (3)                                  |
|   | 2002         | \$208,000       | \$0            | 18,000                         | 0 (3)  |
| Timothy E. Mahoney<br>COO, Chairman (1) (2) (3)                             | 2004         | \$236,265       | \$175,000      | \$0                            | 0  |
|   | 2003         | \$230,265       | \$0            | \$18,900                       | 734,802 (3)                                  |
|   | 2002         | \$208,000       | \$0            | \$18,000                       | 0 (3)  |
| Richard Campanella<br>Chief Operating Officer<br>vFinance Investments, Inc. | 2004         | \$125,000       | \$10,000       | 0                              | 0  |
|   | 2003         | \$125,000       | 0              | 0                              | 75,000                                       |
|   | 2002         | \$125,000       | 0              | 0                              | 75,000                                       |
| David Spector<br>Vice President (4)   | 2004         | \$100,000       | \$15,000       | 0                              | 18,750 (4)                                   |
|   | 2003         | \$100,000       | 0              | 0                              | 550,000                                      |
|   | 2002         | \$100,000       | 0              | 0                              | 25,000                                       |
| Mark Kacer<br>Vice President (5)  | 2003         | \$115,993       | \$10,000       | 0                              | 0  |
|   | 2003         | \$115,993       | \$13,750       | 0                              | 500,000                                      |
|   | 2002         | \$0             | 0              | 0                              | 0  |

(1) Messrs. Sokolow and Mahoney received \$180,000 and 175,000, respectively, in 2004, \$0 in 2003, and \$0 in 2002 of annual incentive compensation based on the performance of the Company during the respective years. These amounts are reflected in the corresponding table as bonuses.

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(2) Messrs. Sokolow and Mahoney each received a \$18,000 car allowance during 2002, \$18,900 in 2003 and \$0 in 2004, which are reflected in the corresponding table as other annual compensation.

(3) Options that were issued in prior years were cancelled in 2002. During 2003, they were each granted 734,802 options.

(4) Mr. Spector's employment with the Company was terminated in December 2004.

(5) Mr. Kacer's employment with the Company was terminated in December 2004.

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### OPTION GRANTS IN LAST FISCAL YEAR

No options were granted to the Chief Executive Officer or the other Named Executive Officers of the Company. In addition, no options were exercised during 2004.

#### Fiscal Year-End Option Table

The following table provides information on the total number of exercisable and unexercisable stock options held at December 31, 2004 by the Named Executive Officers. None of the Named Executive Officers exercised any options during fiscal year 2004.

| Name               | Number of Securities Underlying<br>Unexercised Options at Fiscal Year-End |               | Value of Unexercised<br>Options at Fiscal Year-End |
|--------------------|---|---------------|--|
|                    | -----<br>Exercisable  | Unexercisable | -----<br>Exercisable                               |
| Leonard J. Sokolow | 734,802   | -             | \$ 14,696  |
| Timothy E. Mahoney | 734,802   | -             | 14,696   |
| Richard Campanella | 81,250  | 18,750        | 1,125  |
| David Spector      | 381,250   | -             | 7,625  |
| Mark Kacer         | 300,000   | -             | 9,000  |

(1) Base on the difference between the option's exercise price and a closing price of \$0.23 for the underlying common stock on December 30, 2004 (our last business day of fiscal year 2004) as reported by the National Quotation Bureau.

#### COMPENSATION OF DIRECTORS

Directors do not receive any compensation for serving on our Board of Directors.

#### EMPLOYMENT AGREEMENTS

On November 16, 2004, the Company entered into new agreements ("Primary Employment Agreements") to amend and restate certain employment agreements dated November 8, 1999 between the Company's Chief Executive Officer and President, who is the beneficial owner of 15% and 19.7% of the total outstanding common shares of the Company at December 31, 2004 and 2003, respectively, and the

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Company's Chief Operating Officer and Chairman, who is the beneficial owner of 15% and 19.7% of the total outstanding common shares of the Company at December 31, 2004 and 2003, respectively (collectively the "Primary Shareholders"), as amended on January 5, 2001, July 2, 2001 and January 7, 2002 (the "Previous Employment Agreement"). Under the terms of the Primary Employment Agreements, which shall be for a three year period and shall automatically extended for a one year period on each anniversary date thereafter unless the Company has provided a non-renewal notice thirty (30) days prior to an anniversary date as directed by a majority vote of the board of directors, each individual shall receive (i) an initial base salary of \$257,000 per annum which shall be increase 5% per annum beginning January 1, 2005 and each year thereafter and will be reviewed by the Board at least annually and may be increased (but not decreased) from time to time as Board may determine; (ii) discretionary bonuses and/or interim cash bonuses and/or other bonuses when and in such amounts as may be determined by the Company's board of directors based on each individuals performance, the Company's performance and/or other factors; provided that the Board shall meet at least annually to review employees' bonus entitlements; and (iii) incentive compensation paid quarterly no later than the 45th day following the end of quarter primarily based on performance of the Company and its respective subsidiaries. The Primary Employment Agreements also contain provisions related to change of control.

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### ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table sets forth common stock ownership information as of March 28, 2005 with respect to:

- Each person known to us to be the beneficial owner of more than 5% of our common stock;
- Each of our Named Executive Officers and directors; and
- All directors and officers as a group.

This information as to beneficial ownership was furnished to us by or on behalf of the persons named. Unless otherwise indicated, the business address of each person listed is 3010 North Military Trail, Suite 300, Boca Raton, Florida. Information with respect to the percent of class is based on outstanding shares of common stock as of March 28, 2005. Except as otherwise indicated, to our knowledge, each stockholder has sole power to vote and dispose of all the shares of common stock listed opposite his name.

For purposes of this table, each person is deemed to have beneficial ownership of any shares of our common stock such person has the right to acquire on or within 60 days after March 28, 2005.

| Name of Beneficial Owner                                       | Amount of Shares<br>Beneficially Owned | Percent of Class |
|--|--|------------------|
| -----  | -----                                  | -----            |
| Leonard J. Sokolow(1)  | 6,617,812                              | 16.72%           |
| Timothy E. Mahoney(2)  | 6,617,811                              | 16.72%           |
| Highlands Group Holdings, Inc. (3)                             | 2,175,000                              | 5.42%            |
| David A. Spector (4)   | 125,000                                | *                |
| Richard Campanella (5)   | 406,250                                | *                |
| Mark Kacer   | 300,000                                | *                |
| All executive officers and directors<br>as a group (5 persons) | 13,941,873                             | 34.70%           |

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\* Denotes less than 1% ownership.

(1) Includes 5,883,010 shares of common stock issued in the names of Mr. Sokolow and his wife.

(2) Includes 2,175,000 shares of common stock issued in the name of Highlands Group Holdings, Inc., 3,708,009 shares of common stock issued in the name of Mr. Mahoney.

(3) Highlands Group Holdings, Inc., whose address is 68 Cayman Place, Palm Beach Gardens, Florida 33418, is wholly owned by Mr. Timothy Mahoney, Chairman and Chief Operating Officer. Mr. Mahoney, as the owner of Highlands Group Holdings, Inc., is deemed to beneficially own the 2,175,000 shares held by Highlands Group Holdings, Inc.

(4) Includes 25,000 shares of common stock issued in the name of Mr. Spector.

(5) Includes 25,000 shares of common stock issued in the name of Mr. Campanella.

The following table sets forth certain information as of December 31, 2004, with respect to compensation plans (including individual compensation arrangements) under which our equity securities are authorized for issuance under:

- all compensation plans previously approved by our security holders; and
- all compensation plans not previously approved by our security holders.

|  | Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights | Weighted average<br>exercise price of<br>outstanding options,<br>and rights | remaining available for<br>future issuance under<br>equity compensation plans<br>(excluding securities<br>Plan category warrants<br>reflected in column (a)) |
|--|---|---|--|
|  | (a)   | (b)   | (c)  |
| Equity compensation<br>plans approved by<br>security holders       | -   | -   | -  |
| Equity compensation<br>plans not approved by<br>security holders * | 18,634,635  | 0.67  | -  |
| Total  | 18,634,635  | 0.67  | -  |

\* For a description of the individual compensation arrangements in 2004 See Note 7 to the Consolidated Financial Statements included elsewhere herein.

### ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

None.

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### ITEM 13. EXHIBITS

| Number of<br>Exhibit | Exhibit Description  |
|----------------------|--|
| 2.1                  | Share Exchange Agreement among the Company, vFinance Holdings, Inc., certain shareholders of vFinance Holdings, Inc. and Union Atlantic, dated November 8, 1999 (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on November 8, 1999).  |
| 2.2                  | Amendment to Share Exchange Agreement dated November 29, 1999 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).  |
| 2.3                  | Agreement and Plan of Merger dated as of December 22, 2000, by and among the Company, NW Holdings, Inc., and Alvin S. Mirman, Ilene Mirman, Marc N. Siegel, Richard L. Galterio, Vincent W. Labarbara, Eric M. Rand, and Mario Marsillo, Jr. (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on January 17, 2001). |
| 2.4                  | Agreement and Plan of Merger, dated as of January 3, 2001, by and among the Company, Colonial Acquisition Corp., Colonial Direct Financial Group, Inc., and Michael Golden and Ben Lichtenberg (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on January 17, 2001).   |
| 3.1                  | Certificate of Incorporation as filed with the Delaware Secretary of State on February 12, 1992 (incorporated by reference to the Company's Registration Statement on Form S-18 filed with the SEC on July 24, 1992).  |
| 3.2                  | Certificate of Renewal and Revival of Certificate of Incorporation as filed with the Delaware Secretary of State on March 15, 1996 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).   |
| 3.3                  | Certificate of Amendment to the Certificate of Incorporation as filed with the Delaware Secretary of State on April 28, 1999 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).   |
| 3.4                  | Certificate of Amendment to Certificate of Incorporation as filed with the Delaware Secretary of State on March 13, 2000 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).   |
| 3.5                  | Certificate of Amendment to Certificate of Incorporation as filed with the Delaware Secretary of State on November 28, 2001.   |
| 3.6                  | Certificate of Designation of Series A Convertible Preferred Stock of the Company as filed with the Delaware Secretary of State on January 3, 2001 (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on January 17, 2001).   |
| 3.7                  | Certificate of Designation of Series B Convertible Preferred Stock of the Company as filed with the Delaware Secretary of State on January 3, 2001 (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on  |

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January 17, 2001).

- 3.8 Bylaws of the Company (incorporated by reference to the Company's Registration Statement on Form S-18 filed with the SEC on July 24, 1992).
- 3.9 Unanimous Written Consent of the Company's Board of Directors dated January 24, 1994, amending the Bylaws (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 3.10 Unanimous Written Consent of the Company's Board of Directors, effective as of January 24, 1994, amending the Bylaws (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 10.1 Purchase Agreement between the Company and Steven Jacobs and Mauricio Borgonovo, dated December 24, 1999, for the purchase of Pinnacle Capital Group, LLC (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 10.2 Asset Purchase Agreement among the Company, Steven Jacobs and Mauricio Borgonovo dated January 3, 2000 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 10.3 Stock Purchase Agreement between the Company and River Rapids Ltd., dated September 27, 1999 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 10.4 Amendment to Stock Purchase Agreement between the Company and River Rapids Ltd. dated December 22, 1999 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 30, 2000).
- 10.5 Common Stock and Warrants Purchase Agreement among the Company, AMRO International, S.A., CALP II Limited Partnership, a Bermuda limited partnership, Celeste Trust Reg, Balmore SA, Sallee Investments LLLP, worldVentures Fund I, LLC and RBB Bank Aktiengesellschaft, dated March 31, 2000 (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on April 13, 2000).
- 10.6 Registration Rights Agreement among the Company, AMRO International, S.A., CALP II Limited Partnership, a Bermuda limited partnership, Celeste Trust Reg, Balmore SA, Sallee Investments LLLP, worldVentures Fund I, LLC, RBB Bank Aktiengesellschaft and Thomas Kernaghan & Co., Ltd., dated March 31, 2000 (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on April 13, 2000).
- 10.7 Form of Warrant issued to AMRO International, S.A. (to purchase 100,000 shares), CALP II Limited Partnership, a Bermuda limited partnership (to purchase 350,000 shares), Celeste Trust Reg (to purchase 5,000 shares), Balmore SA (to purchase 35,000 shares),

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Sallee Investments LLLP (to purchase 25,000 shares), worldVentures Fund I, LLC (to purchase 25,000 shares), RBB Bank Aktiengesellschaft (to purchase 130,000 shares) and Thomas Kernaghan & Co., Ltd. (to purchase 58,333 shares) (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC on April 13, 2000).

- 10.8 Escrow Agreement among the Company, AMRO International, S.A., CALP II Limited Partnership, a Bermuda limited partnership, Celeste Trust Reg, Balmore SA, Sallee Investments LLLP, worldVentures Fund I, LLC, RBB Bank Aktiengesellschaft and Epstein Becker & Green, P.C., dated March 31, 2000 (incorporated by reference to Amendment No. 1 to the Company's Registration (Statement on Form SB-2 filed with the SEC on July 14, 2000).
- 10.9\* Amended and Restated Employment Letter Agreement dated December 18, 2000, between the Company and David Spector (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC on March 20, 2001).
- 10.10 Securities Exchange Agreement, dated as of August 15, 2001, among Kathleen Wallman, Steven Wallman, Joseph Daniel and vFinance.com, Inc. (n/k/a vFinance, Inc.) (Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC on August 14, 2001).
- 10.11 Registration Rights Agreement, dated as of August 15, 2001, among Kathleen Wallman, Joseph Daniel and vFinance.com, Inc. (n/k/a vFinance, Inc.) (Incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC on August 14, 2001).
- 10.12 Stock Purchase Warrant, dated August 15, 2001, issued to Kathleen Wallman (incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC on August 14, 2001).
- 10.13 Note Purchase Agreement by and between vFinance.com, Inc. d/b/a vFinance, Inc. (n/k/a vFinance, Inc.) and Best Finance Investments Limited (n/k/a SBI Investments (USA), Inc.) dated November 28, 2001 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.14 Letter Agreement dated November 30, 2001 amending Note Purchase Agreement (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.15 Letter Agreement dated December 14, 2001 amending Note Purchase Agreement (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.16 Letter Agreement dated December 28, 2001 amending Note Purchase Agreement (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.17 Letter Agreement dated February 13, 2002 amending Note Purchase Agreement (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.18 Letter Agreement dated March 4, 2002 amending Note Purchase Agreement (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).



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- 10.19 Credit Facility by and between the Company and UBS Americas, Inc. dated as of January 25, 2002 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.20 Subordination Agreement by and among the Company, UBS Americas, Inc., and SBI Investments (USA), Inc. dated as of January 25, 2002 (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.21 Consulting Agreement effective as of August 20, 2001 by and between vFinance.com, Inc. and Insight Capital Consultants Corporation (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).
- 10.22 Amendment to Credit Agreement dated April 12, 2002 by and between the Company and UBS Americas Inc. (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC April 16, 2002).

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- 10.23 Selected Asset Purchase Agreement dated as of May 29, 2002 among vFinance Investments, Inc., Somerset Financial Partners, Inc., Somerset Financial Group, Inc., Douglas Toth and Nicholas Thompson (the "Select Asset Purchase Agreement") (incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC August 14, 2002).
- 10.24 Amendment to Select Asset Purchase Agreement dated June 17, 2002 (the "Amendment") (incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC August 14, 2002).
- 10.25 Escrow Agreement executed in conjunction with the Amendment (incorporated by reference to the Company's Quarterly Report on Form 10-QSB filed with the SEC August 14, 2002).
- 10.26 Termination Agreement (incorporated by reference to the Company's Quarterly Report on Form 10-QSB/A filed with the SEC November 14, 2002).
- 10.27 Branch Agreement between the Company and JSM Holding Corp (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC March 31, 2003).
- 10.28 Lease agreement on the Company's headquarters in Boca Raton, FL. dated January 1, 2003 between the Company and Zenith Professional Center, LTD. (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC March 30, 2004).
- 10.29 Stock warrant agreement between the Company and Zenith Professional Center, LTD. (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC March 30, 2004).
- 10.30 Asset Purchase Agreement, dated November 2, 2004, by and between vFinance Investments Holdings, Inc. and Global Partners

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Securities, Inc. (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).

- 10.31 Stock Purchase Agreement, dated November 2, 2004, by and between vFinance Investments Holdings, Inc. and Level2.com, Inc. (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).
- 10.32 Registration Rights Agreement, dated November 2, 2004, by and among vFinance, Inc., Global Partners Securities, Inc. and Level2.com, Inc. (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).
- 10.33 Form of Common Stock Purchase Warrant (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).
- 10.34 Stock Escrow Agreement, dated November 2, 2004, by and among vFinance Investments Holdings, Inc., the Company, Global Partners Securities, Inc., Level2.com, Inc., and Edwards & Angell, LLP (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).
- 10.35 Standstill Agreement, dated November 2, 2004, by and among vFinance, Inc. and each of Marcus Konig, Harry Konig and Salomon Konig (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC November 8, 2004).
- 10.36\* Amended and Restated Employment Agreement dated November 16, 2004 between the Company and Leonard J. Sokolow.
- 10.37\* Amended and Restated Employment Agreement dated November 16, 2004 between the Company and Timothy Mahoney.
- 10.38\* Amended and Restated Letter Agreement dated January 14, 2005 between the Company and Sheila C. Reinken (incorporated by reference to the Company's Current Report on Form 8-K filed with the SEC January 21, 2005).
- 10.39\* Employment Agreement dated January 12, 2005 between the Company and Kathleen J. Kennedy.
- 14 Code of Ethics (incorporated by reference to the Company's Annual Report on Form 10-KSB filed with the SEC March 30, 2004).
- 21 List of Subsidiaries
- 31.1 Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by Chief Financial Officer pursuant to Section 1350 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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32.2 Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley act of 2002.

\* Management contract or compensatory plan or arrangement

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ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

During 2004 and 2003, the Company incurred the following fees for professional services rendered by our principal accountant Sherb & Co., LLP:

|                    | 2004       | 2003      |
|--------------------|------------|-----------|
| Audit Fees (1)     | \$ 101,000 | \$ 90,000 |
| Audit-related Fees | -          | -         |
| Tax Fees           | \$ 10,000  | \$ 5,000  |
| All Other Fees     | -          | -         |

(1) Audit Services for 2004 included the annual audit, the reviews of the Company's quarterly reports on Form 10-QSB, fees related to filings with the Securities and Exchange Commission ("SEC") and accounting consultations. Before any audit or non-audit services are performed by any independent accountant, such services must be approved in advance by the Company's board of directors.

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SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

vFinance, Inc.

By: /s/ Leonard J. Sokolow

-----  
LEONARD J. SOKOLOW, DIRECTOR,  
CHIEF EXECUTIVE OFFICER AND PRESIDENT

Date: March 31, 2005

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

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| Signature<br>-----                                    | Capacity<br>-----  | Date<br>----- |
|---|--|---------------|
| /s/ Leonard J. Sokolow<br>-----<br>Leonard J. Sokolow | Director, Chief Executive Officer and<br>President (Principal Executive Officer) | March 31      |
| /s/ Sheila C. Reinken<br>-----<br>Sheila C. Reinken   | Chief Financial Officer and (Principal<br>Financial and Accounting Officer)      | March 31      |
| /s/ Timothy E. Mahoney<br>-----<br>Timothy E. Mahoney | Director, Chairman of the Board and<br>Chief Operating Officer                   | March 3       |

INDEX OF DOCEMENTS FILED WITH THIS ANNUAL REPORT

| Number of Exhibit<br>----- | Exhibit Description<br>-----  |
|----------------------------|---|
| 10.36                      | Amended and Restated Employment Agreement dated November 16, 2004 between the Company and Leonard J. Sokolow. |
| 10.37                      | Amended and Restated Employment Agreement dated November 16, 2004 between the Company and Timothy Mahoney.    |
| 10.39                      | Employment Agreement dated January 12, 2005 between the Company and Kathleen J. Kennedy.                      |
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| 31.1                       | Certification by Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.           |
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| 32.1                       | Certification by Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.           |
| 32.2                       | Certification by Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley act of 2002.           |

