MCF CORP
Form 10-Q
May 09, 2006

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2006

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

For the Transition Period from ________ to ________.

Commission file number: 1-15831

MCF CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware **(State or Other Jurisdiction of Incorporation or Organization)**	**11-2936371** **(I.R.S. Employer Identification No.)**
600 California Street, 9th Floor **San Francisco, CA** **(Address of Principal Executive Offices)**	**94108** **(Zip Code)**

(415) 248-5600
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The number of shares of Registrant's common stock outstanding as of May 8, 2006 was 73,764,711.

Form 10-Q
For the Three Months Ended March 31, 2006

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements (unaudited)

MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)

	Three Months Ended March 31, 2006	Three Months Ended March 31, 2005
Revenue:		
Commissions	$ 8,698,128	$ 6,021,963
Principal transactions	403,301	(373,142)
Investment banking	2,425,780	6,758,810
Other	243,992	65,485
Total revenue	11,771,201	12,473,116
Operating expenses:		
Compensation and benefits	9,929,945	9,201,965
Brokerage and clearing fees	682,604	521,718
Professional services	445,487	271,426
Occupancy and equipment	402,013	349,959
Communications and technology	610,088	423,424
Depreciation and amortization	163,851	105,749
Travel and entertainment	530,370	307,884
Other	398,992	415,232
Total operating expenses	13,163,350	11,597,357
Operating income (loss)	(1,392,149)	875,759
Interest income	111,661	74,827
Interest expense	(69,120)	(17,187)
Income (loss) before income taxes	(1,349,608)	933,399
Income tax expense	0	(284,974)
Net income (loss)	$ (1,349,608)	$ 648,425
Earnings (loss) per share:		
Basic	$ (0.02)	$ 0.01
Diluted	$ (0.02)	$ 0.01
Weighted average common shares outstanding:		
Basic	67,960,593	65,508,467
Diluted	67,960,593	85,485,222

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

MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(unaudited)

	March 31, 2006	December 31, 2005
ASSETS		
Cash and cash equivalents	$ 8,223,483	$ 11,138,923
Cash restricted for fund investment (Note 1)	8,602,547	—
Securities owned:		
Marketable, at fair value	9,256,426	8,627,543
Not readily marketable, at estimated fair value	1,118,803	1,065,743
Restricted cash	630,364	627,606
Due from clearing broker	1,540,421	973,138
Accounts receivable, net	1,848,104	2,073,195
Equipment and fixtures, net	1,298,353	1,378,235
Intangible assets	442,235	394,456
Prepaid expenses and other assets	1,851,456	1,415,574
Total assets	$ 34,812,192	$ 27,694,413
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 1,096,757	$ 901,138
Commissions and bonus payable	3,012,408	4,735,892
Accrued liabilities	1,682,682	2,201,499
Due to clearing and other brokers	133,245	118,798
Securities sold, not yet purchased	21,630	41,579
Capital lease obligation	794,886	883,993
Convertible notes payable, net	6,312,956	176,741
Notes payable	208,819	231,772
Total liabilities	13,263,383	9,291,412
Commitments and contingencies		
Minority interest	1,556,554	—
Stockholders' equity:		
Preferred stock, Series A—$0.0001 par value; 2,000,000 shares authorized; 0 shares issued and outstanding as of March 31, 2006 and December 31, 2005, respectively; aggregate liquidation preference of $0	—	—
Preferred stock, Series B—$0.0001 par value; 12,500,000 shares authorized; 8,750,000 shares issued and 0 shares outstanding as of March 31, 2006 and December 31, 2005; aggregate liquidation preference of $0	—	—
Preferred stock, Series C—$0.0001 par value; 14,200,000 shares authorized; 11,800,000 shares issued and 0 shares outstanding as of March 31, 2006 and December 31, 2005; aggregate liquidation preference of $0	—	—
Common stock, $0.0001 par value; 300,000,000 shares authorized; 73,619,711 and 71,467,118 shares issued and outstanding as of March 31, 2006 and December 31, 2005, respectively	7,362	7,147
Additional paid-in capital	111,516,975	111,725,167

Deferred compensation	—	(3,146,839)
Accumulated deficit	(91,532,082)	(90,182,474)
Total stockholders' equity	19,992,255	18,403,001
Total liabilities, minority interest and stockholders' equity	$ 34,812,192	$ 27,694,413

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

MCF CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Three Months Ended March 31, 2006	2005
Cash flows from operating activities:		
Net income (loss)	$ (1,349,608)	$ 648,425
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	163,851	105,749
Share-based compensation	863,816	525,670
Contingent share-based compensation for Catalyst acquisition	70,325	—
Tax benefits from employee stock options		62,359
Amortization of discounts on convertible notes payable	24,043	2,585
Amortization of debt issuance costs	1,334	—
Unrealized loss on securities owned	206,156	40,720
Other	10,456	—
Changes in operating assets and liabilities:		
Securities owned	(908,048)	(1,395,462)
Restricted cash	(2,758)	—
Due from clearing broker	(567,283)	(255,890)
Accounts receivable	225,091	45,447
Prepaid expenses and other assets	(437,216)	96,858
Accounts payable	195,619	159,825
Commissions and bonus payable	(1,723,484)	1,234,489
Accrued liabilities	(518,817)	(944,159)
Due to clearing and other brokers	14,447	11,433
Net cash provided by (used in) operating activities	(3,732,076)	338,049
Cash flows from investing activities:		
Cash restricted for fund investment	(8,602,547)	—
Purchase of equipment and fixtures	(83,646)	(282,886)
Investment in Catalyst	(58,558)	(345,368)
Net cash used in investing activities	(8,744,751)	(628,254)
Cash flows from financing activities:		
Proceeds from the exercise of stock options and warrants	277,462	20,001
Proceeds from the issuance of common stock	339,430	325,109
Proceeds from the issuance of note payable ($6,112,171) and stock warrant ($1,387,829)	7,500,000	—
Minority interest in fund	1,556,554	—
Debt service principal payments	(112,059)	(63,742)
Net cash provided by financing activities	9,561,387	281,368
Increase (decrease) in cash and cash equivalents	(2,915,440)	(8,837)
Cash and cash equivalents at beginning of period	11,138,923	17,459,113
Cash and cash equivalents at end of period	$ 8,223,483	$ 17,450,276

Supplementary disclosure of cash flow information:				
Cash paid during the period:				
Interest	$	19,958	$	13,047
Income taxes	$	1,800	$	49,000
Non-cash investing and financing activities:				
Issuance of non-vested stock	$	27	$	2,249,252
Purchase of equipment and fixtures on capital lease	$	—	$	80,168
Acquisition of Catalyst	$	—	$	59,487

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

MCF CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Significant Accounting Policies

Basis of Presentation

The interim financial statements included herein for MCF Corporation, or the Company, have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of management, the financial statements included in this report reflect all normal recurring adjustments that the Company considers necessary for the fair presentation of the results of operations for the interim periods covered and the financial position of the Company at the date of the interim statement of financial condition. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. However, the Company believes that the disclosures are adequate to understand the information presented. The operating results for interim periods are not necessarily indicative of the operating results for the entire year. These financial statements should be read in conjunction with the Company's 2005 audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

Cash Restricted for Fund Investment

In March 2006, the Company launched its first proprietary hedge fund managed by MCF Asset Management, LLC. The Company invested $7.5 million into the fund as a limited partner. Accordingly, the Company has consolidated all of the assets and liabilities of the fund, including $8,603,000 of cash and cash equivalents, because the Company has effective control of the fund that results from the large initial percentage interest in the limited partnership. The Company will deconsolidate the assets and liabilities of the fund, including the cash and cash equivalents of the fund, if and when effective control of the fund transfers to other investors in the future. If the Company did not have effective control of the fund as of March 31, 2006, these assets, liabilities and minority interest, including the $8,603,000 of cash and cash equivalents would not have been included in the Company’s consolidated statements of financial condition. Instead, the Company would have recorded an asset representing an investment in the fund managed by MCF Asset Management, LLC which is subject to a one year lock-up provision which makes this investment illiquid for one year.

Securities Owned

“Securities owned” and “Securities sold, but not yet purchased” in the consolidated statements of financial condition consist of financial instruments carried at fair value or amounts that approximate fair value, with related unrealized gains or losses recognized in the results of operations. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

Fair values of the financial instruments are generally obtained from quoted market prices in active markets, broker or dealer price quotations, or alternative pricing sources with reasonable levels of price transparency. To the extent certain financial instruments trade infrequently or are non-marketable securities and, therefore, have little or no price transparency, the Company values these instruments based on management’s estimates. The fair value of these securities is subject to a high degree of volatility and may be susceptible to significant fluctuation in the near term. Securities that contain restrictions are stated at a discount to the value of readily marketable securities. Stock warrants are carried at a discount to fair value as determined by using the Black-Scholes Option Pricing model.

Commissions and Principal Transactions Revenue

Commissions revenue includes revenue resulting from executing stock exchange-listed securities, over-the counter securities and other transactions as agent for the Company’s clients. Principal transactions consist of a portion of dealer spreads attributed to the Company’s securities trading activities as principal in NASDAQ-listed and other securities, and include transactions derived from activities as a market-maker. Additionally, principal transactions include gains and losses resulting from market price fluctuations that occur while holding positions in trading security inventory.

Commissions revenue and related clearing expenses are recorded on a trade-date basis as security transactions occur. Principal transactions in regular-way trades are 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.

MCF CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED
(unaudited)

Investment Banking Revenue

Investment banking revenue includes underwriting and private placement agency fees earned through the Company's participation in public offerings and private placements of equity and convertible debt securities and fees earned as financial advisor in mergers and acquisitions and similar transactions. Underwriting revenue is earned in securities offerings in which the Company acts as an underwriter and includes management fees, selling concessions and underwriting fees. Management fees are recorded on the offering date, selling concessions on settlement date, and underwriting fees at the time the underwriting is completed and the related income is reasonably determinable. Syndicate expenses related to securities offerings in which the Company acts as underwriter or agent are deferred until the related revenue is recognized. Merger and acquisition fees and other advisory service revenue are generally earned and recognized only upon successful completion of the engagement. Underwriting revenue is presented net of related expenses. Unreimbursed expenses associated with private placement and advisory transactions are recorded as expenses as incurred.

As co-manager for registered equity underwriting transactions, management must estimate the Company's share of transaction related expenses incurred by the lead manager in order to recognize revenue. Transaction related expenses are deducted from the underwriting fee and therefore reduces the revenue that is recognized as co-manager. Such amounts are adjusted to reflect actual expenses in the period in which the Company receives the final settlement, typically 90 days following the closing of the transaction.

Share-Based Compensation Expense

On January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123(R), "Share-Based Payment," which requires the measurement and recognition of compensation expense, based on estimated fair values, for all share-based awards, made to employees and directors, including stock options, non-vested stock, and participation in the Company's employee stock purchase plan. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107 relating to SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

The Company adopted SFAS 123(R) using the modified prospective application transition method, as of January 1, 2006, the first day of the Company's fiscal year 2006. The Company's consolidated financial statements as of and for the three months ended March 31, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective application transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Share-based compensation expense recognized under SFAS 123(R) for the three months ended March 31, 2006 was $934,000, which includes $70,000 of share-based compensation issued in connection with the acquisition of Catalyst (see Note 4).

Prior to the adoption of SFAS 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with