FORM 10KSB/A

Annual and transition reports of small business issuers [Section 13 or 15(d), not S-B Item 405]
[amend]

Filing Date: **2001-08-03** | Period of Report: **1999-12-31**
SEC Accession No. 0000912057-01-526540

(HTML Version on secdatabase.com)

FILER

PAULSON CAPITAL CORP

CIK:**704159**| IRS No.: **930589534** | State of Incorp.:**OR** | Fiscal Year End: **1231**
Type: **10KSB/A** | Act: **34** | File No.: **000-18188** | Film No.: **1697503**
SIC: **6211** Security brokers, dealers & flotation companies

Mailing Address
811 SW FRONT AVE
PORTLAND OR 97204

Business Address
811 SW FRONT AVE
SUITE 200
PORTLAND OR 97204
5032436000

<Page>

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended December 31, 1999

Commission file number: 0-18188

FORM 10-KSB/A

(Amendment No. 2)

PAULSON CAPITAL CORP.

Name of small business issuer as specified in its charter

OREGON	93-0589534
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
811 S.W. Naito Parkway, Suite 200 Portland, OR	97204
(Address of principal executive offices)	(Zip Code)

Issuer's telephone number, including area code: (503) 243-6000

Securities registered pursuant to Section 12(b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, no par value

Title of class

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 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 X No ---

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not 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 II of this Form 10-KSB or any amendment to this Form 10-KSB.

<Page>

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

<Table>
<Caption>

(a) FINANCIAL STATEMENTS	PAGE
<S>	<C>
Report of Independent Certified Public Accountants	F-1
Consolidated Balance Sheets as of December 31, 1999 and 1998	F-2

Consolidated Statements of Operations for the years ended December 31, 1999, 1998 and 1997	F-3
Consolidated Statement of Shareholders' Equity for the years ended December 31, 1999, 1998 and 1997	F-4
Consolidated Statements of Cash Flows for the years ended December 31, 1999, 1998 and 1997	F-5
Notes to Consolidated Financial Statements	F-7
Supplementary Schedule of Warrants Owned	F-19
Schedule II - Valuation and Qualifying Account	F-20

</Table>

<Page>

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors and Shareholders
Paulson Capital Corp.

We have audited the accompanying consolidated balance sheets of Paulson Capital Corp. (an Oregon corporation) and Subsidiary as of December 31, 1999 and 1998, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1999. 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 auditing standards generally accepted in the 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 consolidated financial position of Paulson Capital Corp. and Subsidiary as of December 31, 1999 and 1998, and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

As discussed in Note N of Notes to Consolidated Financial Statements, the 1998 and 1997 financial statements have been restated.

Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The accompanying Supplementary Schedule of Warrants Owned as of December 31, 1999 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic consolidated financial statements taken as a whole.

We have also audited Schedule II for each of the three years in the period ended December 31, 1999. In our opinion, this schedule presents fairly, in all material respects, the information required to be set forth therein.

/s/ Grant Thornton LLP

Portland, Oregon

January 26, 2000, except for Notes E and N,
as to which the date is April 5, 2000

<Page>

Paulson Capital Corp. and Subsidiary

CONSOLIDATED BALANCE SHEETS

December 31,

<Table>
<Caption>

<S>	1999 <C>	1998 (restated) <C>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 48,210	$ 100,345
Receivable from broker-dealers and clearing organizations	7,336,562	1,430,586
Notes and other receivables	671,514	439,967
Trading securities	2,238,798	2,119,737
Investment securities	14,200,767	9,697,387
Underwriter warrants	10,490,000	2,488,000
Refundable income taxes	-	168,059
Prepaid and deferred expenses	669,599	578,556
Deferred income taxes	-	53,373
Total current assets	35,655,450	17,076,010
NOTE RECEIVABLE	1,100,000	-
FURNITURE AND EQUIPMENT, net	525,716	359,329
INVESTMENT IN REAL ESTATE	169,900	169,900
	$ 37,451,066	$ 17,605,239
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 814,935	$ 738,155
Payable to broker-dealers and clearing organizations	1,883,602	753,413
Compensation, employee benefits and payroll taxes	3,312,829	1,240,510
Securities sold, not yet purchased	65,794	61,479
Income taxes payable	1,116,800	-
Deferred income taxes	4,842,500	-
Total current liabilities	12,036,460	2,793,557
SHAREHOLDERS' EQUITY		
Preferred stock, no par value; authorized, 500,000 shares; issued and outstanding, no shares	-	-
Common stock, no par value; authorized, 10,000,000 shares; issued and outstanding, 3,541,235 and 3,796,852, respectively	732,343	775,323
Retained earnings	24,682,263	14,036,359

	25,414,606	14,811,682
	$ 37,451,066	$ 17,605,239

</Table>

The accompanying notes are an integral part of these statements.

<Page>

Paulson Capital Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF OPERATIONS

Year ended December 31, 1999

<Table>
<Caption>

<S>	1999 <C>	1998 (restated) <C>	1997 (restated) <C>
Revenues			
Commissions	$ 15,075,567	$ 11,324,412	$ 12,728,794
Corporate finance	2,115,619	1,716,691	3,925,514
Investment income (loss)	21,640,280	(1,949,262)	9,792,011
Trading income	317,159	589,822	1,195,585
Interest and dividends	16,641	48,668	7,010
Other	21,316	19,201	35,147
	39,186,582	11,749,532	27,684,061
Expenses			
Commissions and salaries	15,692,933	10,370,979	12,551,806
Underwriting expenses	1,350,372	731,035	762,317
Rent, telephone and quotation services	890,708	842,437	835,472
Interest expense	1,248	60,889	5,996
Professional fees	394,368	389,478	639,386
Bad debt expense	-	267,193	-
Travel and entertainment	333,927	283,234	158,649
Settlements	59,000	518,362	67,299
Other	1,152,530	1,015,582	1,534,148
	19,875,086	14,479,189	16,555,073
Earnings (loss) before income taxes	19,311,496	(2,729,657)	11,128,988
Income tax expense (benefit)	7,600,260	(961,017)	4,178,593
NET EARNINGS (LOSS)	$ 11,711,236	$ (1,768,640)	$ 6,950,395
Basic earnings (loss) per share	$ 3.16	$ (.45)	$ 1.75
Diluted earnings (loss) per share	$ 3.16	$ (.45)	$ 1.74

</Table>

The accompanying notes are an integral part of these statements.

<Page>

Paulson Capital Corp. and Subsidiary

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

Three year period ended December 31, 1999

<Table>
<Caption>

	Common Stock Shares	Common Stock Amount	Retained Earnings
Balance at December 31, 1996, as previously reported	4,081,241	$ 733,701	$ 9,164,846
Restatement (Note N)	-	-	671,000
Balance at December 31, 1996, as restated	4,081,241	733,701	9,835,846
Exercise of stock options	87,140	89,283	-
Issuance of common stock in lieu of directors' cash compensation	2,266	8,000	-
Redemption of common stock	(200,111)	(36,568)	(529,919)
Net earnings for the year, as restated	-	-	6,950,395
Balance at December 31, 1997, as restated	3,970,536	794,416	16,256,322
Issuance of common stock in lieu of directors' cash compensation	4,283	16,500	-
Redemption of common stock	(177,967)	(35,593)	(451,323)
Net loss for the year, as restated	-	-	(1,768,640)
Balance at December 31, 1998, as restated	3,796,852	775,323	14,036,359
Issuance of common stock in lieu of directors' cash compensation	1,783	8,500	-
Redemption of common stock	(257,400)	(51,480)	(1,065,332)
Net earnings for the year	-	-	11,711,236
Balance at December 31, 1999	3,541,235	$ 732,343	$ 24,682,263

</Table>

The accompanying notes are an integral part of this statement.

<Page>

Paulson Capital Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31,

<Table>
<Caption>

	1999	1998 (restated)	1997 (restated)
Increase (Decrease) in Cash and Cash Equivalents			
Cash flows from operating activities			
Net earnings (loss)	$ 11,711,236	$ (1,768,640)	$ 6,950,395
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities			
Unrealized (appreciation) depreciation on investment securities and underwriter warrants	(13,556,395)	1,816,738	(3,803,194)

Realized (gain) loss on investment securities	(8,083,884)	404,441	(5,988,817)
Deferred income taxes	4,895,873	(1,796,273)	1,448,300
Common stock issued for compensation of directors	8,500	16,500	8,000
Depreciation and amortization	136,274	89,448	59,994
(Gain)/loss from sale of furniture and equipment	-	6,180	(6,800)
Write-down of notes receivable, net of recoveries	(267,193)	267,193	-
Changes in assets and liabilities			
Receivables	(6,082,055)	3,051,643	562,999
Trading securities	(119,061)	6,782,065	(3,749,019)
Income taxes receivable/payable	1,284,859	(66,152)	310,354
Prepaid and deferred expenses	(91,043)	(177,711)	(240,724)
Accounts payable and accrued liabilities	3,279,288	(5,516,418)	2,236,523
Securities sold, not yet purchased	4,315	(269,250)	50,041
Net cash provided by (used in) operating activities	(6,879,286)	2,839,764	(2,161,948)
Cash flows from investing activities			
Purchases of investment securities	(41,501,353)	(27,439,553)	(28,103,962)
Proceeds from sale of investment securities	50,636,252	25,400,567	31,405,663
Proceeds from repayment of notes receivable	211,725	500,000	-
Issuance of note receivable	(1,100,000)	(534,385)	(500,000)
Additions to furniture and equipment	(302,661)	(254,652)	(114,474)
Purchase of real estate	-	-	(169,900)
Proceeds from sale of furniture and equipment	-	2,300	9,600
Net cash provided by (used in) investing activities	7,943,963	(2,325,723)	2,526,927

</Table>

The accompanying notes are an integral part of these statements.

<Page>

Paulson Capital Corp. and Subsidiary

CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

Year ended December 31,

<Table>
<Caption>

<S>	1999 <C>	1998 (restated) <C>	1997 (restated) <C>
Cash flows from financing activities			
Proceeds from exercise of stock options	$ -	$ -	$ 89,283
Payments to retire common stock	(1,116,812)	(486,916)	(566,487)
Net cash used in financing activities	(1,116,812)	(486,916)	(477,204)
Net Increase (Decrease) in Cash and Cash Equivalents	(52,135)	27,125	(112,225)
Cash and cash equivalents at beginning of year	100,345	73,220	185,445
Cash and cash equivalents at end of year	$ 48,210	$ 100,345	$ 73,220
CASH PAID DURING THE YEAR FOR			
Interest	$ 1,248	$ 61,389	$ 6,000
Income taxes	$ 1,441,715	$ 901,408	$ 2,405,275
NONCASH INVESTING AND FINANCING ACTIVITY			
Repayment of secured demand note collateral agreement	$ -	$ 100,000	$ -

</Table>

The accompanying notes are an integral part of these statements.

<Page>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Paulson Capital Corp. (the Company) is a holding company whose wholly-owned subsidiary, Paulson Investment Company, Inc. (Subsidiary) is a registered broker-dealer in securities under the Securities and Exchange Act of 1934, as amended. The Subsidiary renders broker-dealer services in securities on both an agency and principal basis to its customers who are fully introduced to Correspondent Services Corporation (CSC), a subsidiary of Paine Webber Group, Inc. The Subsidiary also acts as lead or participating underwriter for over-the-counter securities offerings. The Subsidiary conducts business throughout the United States. The Subsidiary is exempt from the reserve requirements under SEC Rule 15c3-3(k)(2)(ii), since it does not handle or carry customer securities and cash.

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows.

1. PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of Paulson Capital Corp. and its wholly-owned subsidiary, Paulson Investment Company, Inc. All significant intercompany balances and transactions have been eliminated in the consolidation.

2. SECURITIES TRANSACTIONS

Securities transactions and related revenue are recorded on a trade date basis. Manager's fees, underwriter's fees, and other underwriting revenues are recognized at the time the underwriting is completed. Tax shelter revenue is recognized at the time individual tax shelter units are sold.

Marketable securities are valued at market value, and securities not readily marketable are valued at fair value as determined by management. The fair value of not readily marketable securities is estimated by management using available information including the following: Quoted market prices of similar securities (i.e. unrestricted shares of the same company); price of recent known trades of the same or similar securities; the cost of the security if recently purchased adjusted for changes in the financial condition of the issuer; all other information available from review of available documents related to the issuer or discussions with management of the issuer. Changes in the value of these securities are reflected currently in the results of operations.

3. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reflected in the balance sheet for cash, cash equivalents, notes and other receivables and payables approximate their respective fair values due to the short maturities of these instruments. The fair values of trading and investing securities owned and securities sold, not yet purchased are recorded primarily at quoted prices for those or similar instruments. Underwriter warrants are recorded at estimated fair value as determined by management. Changes in the market value of these securities are reflected currently in the results of operations.

4. FURNITURE AND EQUIPMENT

Depreciation of furniture and equipment is computed generally by the straight-line method over their estimated useful lives (5 years). Leasehold improvements are amortized over the lesser of their estimated useful life or the lives of their respective leases (2.5 years).

<Page>

NOTE A - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. CASH FLOWS

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, cash due from banks and brokerage accounts, certificates of deposit and highly liquid debt instruments purchased with a maturity of three months or less.

6. USE OF ESTIMATES

In preparing the Company's financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

7. EARNINGS PER SHARE

The Company adopted Financial Accounting Standard No. 128, "Earnings Per Share" in 1997. Earnings (loss) per share are computed based on the weighted average number of common and dilutive common equivalent shares outstanding during the year (Note I).

8. INCOME TAXES

The Company provides for income taxes under the liability method. Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities as measured by the enacted tax rates which are expected to be in effect when these differences reverse. Income tax expense is the tax payable for the period and the change during the period in net deferred tax assets and liabilities.

9. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 133 ("SFAS 133"), Accounting for Derivative Instruments and Hedging Activities. SFAS 133 will require the Company to record all derivatives on the balance sheet at fair value. The new standard, as amended by SFAS 137 and SFAS 138, is effective for fiscal years beginning after June 15, 2000. As part of certain underwriting agreements, the Company receives underwriter warrants. These warrants are derivatives under the definition of SFAS 133. The Company does not have any hedging activities. The Company believes the impact of adopting this standard will not be material to its results of operations or equity since it currently marks all investments to fair value.

<Page>

NOTE B - RECEIVABLE FROM AND PAYABLE TO BROKER-DEALERS AND CLEARING ORGANIZATIONS

The Subsidiary introduces all customer transactions in securities traded on U.S. securities markets to CSC on a fully-disclosed basis. The agreement between the Subsidiary and its clearing broker provides that the Subsidiary is obligated to assume any exposure related to nonperformance by customers or counterparties. The Subsidiary monitors clearance and settlement of all customer transactions on a daily basis.

The exposure to credit risk associated with the nonperformance of customers and counterparties in fulfilling their contractual obligations pursuant to these securities transactions can be directly impacted by volatile trading markets which may impair the customer's or counterparty's ability to satisfy their obligations to the Subsidiary. In the event of nonperformance, the Subsidiary may be required to purchase or sell financial instruments at unfavorable market prices resulting in a loss. Management does not anticipate nonperformance by customers and counterparties in the above situations.

In addition to the clearing services provided, CSC also loans money to the Subsidiary to finance trading accounts.

<Page>

NOTE B - RECEIVABLE FROM AND PAYABLE TO BROKER-DEALERS AND CLEARING ORGANIZATIONS - Continued

At December 31, the above clearing services and trading account financing resulted in the following:

<Table>
<Caption>

<S>	1999 <C>	1998 <C>
Receivable from CSC	$ 7,336,562	$ 1,430,586
Payable to CSC	(1,883,602)	(753,413)
Net receivable	$ 5,452,960	$ 677,173

</Table>

NOTE C - NOTES AND OTHER RECEIVABLES

Notes and other receivables consist of the following:

<Table>
<Caption>

<S>	1999 <C>	1998 <C>
Underwriting	$ -	$ 267,191
Employees	558,131	49,493
Independent brokers	59,045	69,909
Other	54,338	53,374
	$ 671,514	$ 439,967

</Table>

In connection with an underwriting, the Subsidiary accepted a note receivable on December 18, 1997 in the amount of $500,000. On February 6, 1998 the note was paid. Three additional notes totaling $534,385 were accepted during 1998. These notes were uncollateralized and the Subsidiary recorded an allowance of $267,193 against them. During 1999, collection was received on one of the notes and the remainder of the other two were written off.

Employee and independent broker receivables relate principally to advances, expenses inventory losses and settlements charged to the registered representatives of the Subsidiary in excess of commission earnings. For the years ended December 31, 1999, 1998, and 1997, receivables from employees and independent brokers of $80,379, $85,448, and $17,206, respectfully, were determined by management to be uncollectible and written off.

At December 31, 1999 the Company had a $1,100,000 unsecured note receivable from a company that was subordinated to the interest of another creditor. This note has an interest rate of 6% and is due October 21, 2001.

<Page>

NOTE D - TRADING AND INVESTMENT SECURITIES

Trading securities and securities sold not yet purchased represent the market value of securities held long and short by the Company's subsidiary.

The categories of trading securities and their related market values follow:

<Table>
<Caption>

	1999		1998	
	Long	Short	Long	Short
<S>	<C>	<C>	<C>	<C>
Common stock	$ 1,895,409	$ 65,794	$ 1,686,731	$ 50,672
Preferred stock	-	-	39,008	5,511
State and municipal bonds	262,082	-	243,055	5,296
Corporate bonds	81,307	-	150,943	-
	$ 2,238,798	$ 65,794	$ 2,119,737	$ 61,479

</Table>

As a securities broker-dealer, the Subsidiary is engaged in various securities trading and brokerage activities as principal. In the normal course of business, the Subsidiary has sold securities that it does not currently own and will therefore be obligated to purchase such securities at a future date. This obligation is recorded in the financial statements at the market value of the related securities. A trading loss will occur on the securities if the market price increases and a trading gain will occur if the market price decreases.

Investment securities held by the Subsidiary which are readily marketable are stated at market value. Included in investment securities are certain securities which are not readily marketable. Securities not readily marketable include investment securities (a) for which there is no market on a securities exchange or no independent publicly quoted market, (b) that cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933, or (c) that cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities or to the Company. At December 31, 1999 these securities consist of corporate stocks and warrants at estimated fair value of $914,210 and a convertible debenture valued at $100,000. At December 31, 1998 these securities consisted of corporate stocks at estimated fair value of $325,475. A summary of the investment security portfolio follows:

<Table>
<Caption>

	Cost	Market Value	Unrealized Gain (Loss)	Carrying Value
<S>	<C>	<C>	<C>	<C>
1999				
Corporate equities	$11,752,070	$14,178,877	$ 2,426,807	$14,178,877
Corporate bonds	102,420	21,890	(80,530)	21,890
	$11,854,490	$14,200,767	$ 2,346,277	$14,200,767
1998				
Corporate equities	$11,993,688	$ 9,697,387	$ (2,296,301)	$ 9,697,387

</Table>

Realized gain (loss) included in the determination of net earnings was $8,083,884, $(404,441), and $5,988,817 for the years ended December 31, 1999, 1998 and 1997, respectively.

<Page>

NOTE E - UNDERWRITER WARRANTS

As provided in certain underwriting agreements, Paulson Investment Company, Inc. obtains warrants to purchase equity instruments from client companies. During the restriction periods on these warrants, the Company recognizes no value. When the restrictions expire and the underlying securities become exercisable, the Company marks the warrants to estimated fair value.

The estimated fair value of warrants is determined in good faith by management taking into consideration all indications of value and factors relevant to the value of the warrant (Note A2) that are available.

The following table summarized activity in underwriter warrants:

<Table>

<S>	<C>
Estimated fair value at January 1, 1997	$ 1,088,000
Unrealized gain	4,211,000
Estimated value at December 31, 1997	5,299,000
Unrealized loss	(2,811,000)
Estimated fair value at December 31, 1998	2,488,000
Realized gain	(6,852,854)
Unrealized gain	14,854,854
Estimated fair value at December 31, 1999	$10,490,000

</Table>

NOTE F - FURNITURE AND EQUIPMENT

Furniture and equipment are stated at cost and consist of the following:

<Table>
<Caption>

<S>	1999 <C>	1998 <C>
Office equipment	$ 1,173,097	$ 905,710
Leasehold improvements	35,274	120,354
Vehicles	65,619	65,619
	1,273,990	1,091,683
Less accumulated depreciation and amortization	748,274	732,354
	$ 525,716	$ 359,329

</Table>

<Page>

NOTE G - INCOME TAXES

Income tax expense (benefit) consists of the following:

<Table>
<Caption>

	1999	1998	1997
Current tax expense			
Federal	$ 1,921,593	$ 724,613	$ 2,364,177
State	782,794	110,643	366,116
	2,704,387	835,256	2,730,293
Deferred tax expense (benefit)			
Federal	4,338,537	(1,579,461)	1,289,457
State	557,336	(216,812)	158,843
	4,895,873	(1,796,273)	1,448,300
	$ 7,600,260	$ (961,017)	$ 4,178,593

</Table>

<Page>

NOTE G - INCOME TAXES - Continued

Income tax expense (benefit) for each year varies from the amount computed by applying the statutory federal income tax rate to earnings (loss) before taxes as follows:

<Table>
<Caption>

	1999	1998	1997

Income tax expense (benefit) at statutory federal tax rate	$ 6,566,000	$ (928,000)	$ 3,784,000
State taxes net of federal benefit	841,000	(119,000)	485,000
Permanent and other differences	193,260	85,983	(90,407)
	$ 7,600,260	$ (961,017)	$ 4,178,593

</Table>

The deferred income tax asset (liability) consists of the following at December 31,:

<Table>
<Caption>

<S>	1999 <C>	1998 <C>
Unrealized appreciation on securities	$(4,923,000)	$ (55,000)
Accrued expenses	48,000	-
State net operating loss carryforwards	67,100	-
Allowance on notes receivable	-	105,000
Fixed asset depreciation	(34,600)	3,373
	$(4,842,500)	$ 53,337

</Table>

No valuation allowance is considered necessary. The state net operating loss carryforwards expire through 2014.

NOTE H - COMMON STOCK

Directors are compensated for their attendance at a maximum of six scheduled meetings per year. Compensation is approximately $500 of the Company's stock for each meeting. The value of the stock is determined at the close of business the day prior to a scheduled meeting.

The Subsidiary has a key employee stock purchase plan. Under the plan, the Subsidiary will match funds (up to $25,000) committed by key employees for the purchase of shares of the Company's common stock. The committed and matching funds will be used by the Subsidiary to purchase stock of the Company in the open market or by negotiated transactions. One half of the shares will be resold to the participating employee and one half of the shares will be transferred to the employee for no cash consideration. The named participants, the number of shares purchased in the open market and the amount of matching funds will be at the discretion of the Board of Directors of the Subsidiary. No participants were named and no purchases of common stock under this plan were made during 1999, 1998 or 1997.

The Company's Nonemployee Stock Option Plan had 100,000 registered shares of common stock reserved for issuance.

<Page>

NOTE H - COMMON STOCK - Continued

The Company has adopted the disclosure only provisions of Financial Accounting Standard No. 123, "Accounting for Stock-Based Compensation" (FAS 123). It applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its Plans and therefore does not recognize compensation expense. Had the Company elected to recognize compensation expense based upon the fair value at the grant date for awards under these Plans consistent with the methodology prescribed by FAS 123, the effect on the Company's pro forma net income and earnings per share would have been immaterial. The fair value of each option grant is estimated on the date of grant using the Black-Scholes options-pricing model with the following weighted-average assumptions: no dividends; expected volatility of 62%; risk-free interest rate of 5.9% and expected life of 2.5 years.

There was no activity under the Nonemployee Stock Option Plan during 1999 or 1998. The following table summarizes activity under the Plan for the year ended December 31, 1997:

<Table>
<Caption>

<S>	Shares Under Option <C>	Weighted Average Exercise Price <C>
Balance at December 31, 1996	101,425	$ 1.01
Granted	-	-
Exercised	(87,140)	1.02
Canceled	(14,285)	.91
Balance at December 31, 1997	-	

</Table>

On September 30, 1999, the Board of Directors approved the 1999 Stock Option Plan. The plan reserves 500,000 shares of the Company's common stock for issuance upon exercise of the options. Also effective September 30, 1999, the Board of Directors approved the grant of 128,000 options to directors and employees of the Company. The approved grant price of the options was $4.44 per share, the September 30, 1999 market value. However, the plan is subject to shareholder approval at the June 2000 shareholder meeting. Because approval is not virtually certain, the options have not been included in the diluted earnings per share calculation for the year ended December 31, 1999. If the market value of the stock, on the date of approval, is greater than the grant price, the Company will incur compensation expense equal to the price per share differential times the number of shares granted.

<Page>

NOTE I - EARNINGS PER SHARE

The following table is a reconciliation of the numerators and denominators of the basic and diluted per share computations for each of the three years in the period ended December 31, 1999:

<Table>
<Caption>

	Income	Weighted Average Shares	Per Share

	(Numerator)	(Denominator)	Amount
<S>	<C>	<C>	<C>
1997 (restated)			
Basic earnings per share			
Income available to common stockholders	$ 6,950,395	3,973,034	$1.75
Effect of dilutive securities			
Stock options	-	32,344	
Diluted earnings per share			
Income available to common stockholders	$ 6,950,395	4,005,378	$1.74
1998 (restated)			
Basic earnings (loss) per share			
Income (loss) available to common stockholders	$ (1,768,640)	3,917,788	$(.45)
1999			
Basic earnings per share			
Income available to common stockholders	$ 11,711,236	3,704,360	$3.16

</Table>

During the years ended December 31, 1999 and 1998 there were no potentially dilutive securities outstanding. During the year ended December 31, 1997 all outstanding stock options were included in the computation of diluted earnings per share since the options' exercise price was less than the average market price of the common shares.

<Page>

NOTE J - LEASES

Future minimum payments, by year and in the aggregate, required under non-cancelable operating leases with initial or remaining terms of one year or more consist of the following:

<Table>
<Caption>

Year ended December 31,	
<S>	<C>
2000	$ 274,176
2001	274,176
2002	114,240
	$ 662,592

</Table>

The leases provide for payment of taxes and other expenses by the Company. Rental expense for the years ended December 31, 1999, 1998 and 1997 approximated $265,000, $270,000, and $240,000, respectively.

NOTE K - EMPLOYEE BENEFIT PLANS

Retirement benefits for employees of the Company, who have completed certain service requirements, are provided by a defined contribution profit-sharing plan. Plan contributions are determined by the Board of Directors. Contributions to the plan for the years ended December 31, 1999, 1998 and 1997 were $600,000, $0 and $500,000, respectively.

NOTE L - CONTINGENCIES

The Company and its Subsidiary have been named by individuals in certain legal actions, some of which claim state and federal securities law violations and claim principal and punitive damages. As preliminary hearings and discovery in these cases is not complete, it is not possible to assess the degree of liability, the probability of an unfavorable outcome or the impact on the Company's financial statements, if any. Management denies the charges in these legal actions and is vigorously defending against them. No provision for any liability that may result from the above contingencies has been made in the financial statements.

The Company and its Subsidiary are defendants in a class action alleging violations of California securities law and other laws relating to a public offering in which the Subsidiary acted as the managing underwriter. The Subsidiary and the plaintiffs reached a settlement in principle during 1998, which is subject to court approval. The total payment by the Subsidiary under the settlement depends upon the number of purchasers in the public offering who file valid claims. Management believes the range of payment possible under the settlement is between approximately $350,000 and $900,000. An accrual of $500,000 has been recorded based upon management's estimate of the most likely amount.

NOTE M - NET CAPITAL REQUIREMENT

The Subsidiary is subject to the net capital rule (Rule 15c3-1) of the Securities and Exchange Commission. This rule prohibits the Subsidiary from engaging in any securities transaction at a time when its "aggregate indebtedness" exceeds fifteen times its "net capital" as those terms are defined by the rule. At December 31, 1999, the Subsidiary's net capital and required net capital were $17,506,585 and $273,057, respectively, and its ratio of aggregate indebtedness to net capital was .234 to 1. The Subsidiary's absolute minimum net capital is $100,000.

<Page>

NOTE N - RESTATEMENT

During the fourth quarter of 1999, the Company changed its method of accounting for underwriter warrants. Previously the Company recognized no value for these warrants. Upon reconsideration, it was determined that it is appropriate under generally accepted accounting principles to carry these securities at their estimated fair value. Accordingly, the financial statements for previous periods have been restated to correct this error in previously issued financial statements that were not in compliance with existing accounting principles generally accepted in the United States.

The effect of the change on the 1999 financial statements was to increase investment income and earnings before income taxes by $8,002,000, net income by $4,933,000 and basic and diluted earnings per share by $1.33. For the year ended December 31, 1998, the effect of the restatement was to decrease investment income and earnings before income taxes by $2,811,000 increase net loss by $1,733,000 and increase the basic and diluted loss per share by $.44. For the year ended December 31, 1997, the effect of the restatement was to increase investment income and earnings before income taxes by $4,211,000, increase net income by $2,596,000 and increase the basic and diluted earnings per share by $.65. The effect of the adjustment for periods prior to 1997 was to increase shareholders' equity by $671,000.

The effect of the restatement on each of the quarters for the years 1999, 1998 and 1997 is as follows (unaudited):

	Three months ended			
	March 31,	June 30,	September 30,	December 31,
1999				
Net income (loss), as previously reported	$ 7112,963	$ 1,269,203	$ (426,746)	$ 5,822,816
Effect of adjustment	936,000	2,398,000	1,603,000	(4,000)
Net income, as restated	$ 1,048,963	$ 3,667,203	$ 1,176,254	$ 5,818,816
Earnings (loss) per share, as previously reported	$ 0.03	$ 0.34	$ (0.12)	$ 1.61
Effect of adjustment	0.25	0.63	0.44	-
Earnings per share, as restated	$ 0.28	$ 0.97	$ 0.32	$ 1.61
1998				
Net income (loss), as previously reported	$ 173,604	$ (879,490)	$ (2,101,563)	$ 2,771,809
Effect of adjustment	(152,000)	(1,086,000)	(740,000)	245,000
Net income (loss), as restated	$ 21,604	$(1,965,490)	$ (2,841,563)	$ 3,016,809
Earnings (loss) per share, as previously reported	$ 0.04	$ (0.22)	$ (0.55)	$ 0.70
Effect of adjustment	(0.03)	(0.28)	(0.17)	0.09
Earnings (loss) per share, as restated	$ 0.01	$ (0.50)	$ (0.72)	$ 0.79
1997				
Net income, as previously reported	$ 791,059	$ 583,370	$ 1,807,880	$ 1,172,086
Effect of adjustment	250,000	1,311,000	2,032,000	(997,000)
Net income, as restated	$ 1,041,059	$ 1,894,370	$ 3,839,880	$ 175,086
Earnings per share, as previously reported	$ 0.20	$ 0.15	$ 0.45	$ 0.30
Effect of adjustment	0.06	0.33	0.52	(0.26)
Basic earnings per share, as restated	$ 0.26	$ 0.48	$ 0.97	$ 0.04
Diluted earnings per share, as previously reported	$ 0.20	$ 0.15	$ 0.45	$ 0.29
Effect of adjustment	0.06	0.32	0.52	(0.25)
Diluted earnings per share, as restated	$ 0.26	$ 0.47	$ 0.97	$ 0.04

<Page>

Paulson Capital Corp. and Subsidiary

SCHEDULE OF WARRANTS OWNED

December 31,

	Shares Entitled to	Exercise Price	Expiration

Description	Purchase	Per-Share	Date
<S>	<C>	<C>	<C>
Advantage Marketing Systems* (units)	65,520	$ 5.40	2002, 11/12
Audiohighway* (units)	163,900	$ 7.80	2003, 12/17,
AVI Biopharma, Inc.* (units)	112,700	$ 10.80	2002, 06/03
C3, Inc.*	214,592	$ 18.00	2002, 11/14
Cal-Maine Foods, Inc.*	177,100	$ 8.40	2001, 12/10
Caring Products International, Inc.* (units)	83,075	$ 6.00	2002, 12/09
Cell Robotics International, Inc. (units)	9.3725	$ 25,000.00	2000, 09/18
Cell Robotics International, Inc.* (units)	29,800	$ 9.90	2003, 02/01
Cellegy Pharmaceuticals, Inc.* (units)	18,745	$ 20.63	2000, 08/11
Complete Management, Inc.*	107,720	$ 10.80	2000, 12/27
Complete Management, Inc.*	31,377	$ 21.04	2001, 06/11
Cusac Industries, Ltd.* (units)	11,901	$ 12.00	2000, 01/11
E.Com International, Inc.*	75,587	$ 3.50	2002, 12/31
Evergreen Resources, Inc.	134,375	$ 6.90	2001, 10/22
Fortune Petroleum Corp.*	50,000	$ 4.00	1999, 05/19
Global Payment Technology ERC 2-6-96	103,500	$ 6.60	2000, 02/06
Hometown Auto Retailers NC*	120,690	$ 10.80	2003, 07/28
International Nursing Services, Inc.* (units)	15,301	$ 28.20	1999, 09/12
Kyzen Corporation* (units)	15,498	$ 14.95	2000, 08/03
Microfield Graphics, Inc.*	79,750	$ 7.20	2000, 06/22
Microvision Inc. (units) ERC 8-27-97	123,760	$ 9.60	2001, 08/27
Neotherapeutics Inc. (units) ERC 9-25-97	161,000	$ 9.12	2001, 09/25
Northern Bank of Commerce ERC 8-4-94	2,000	$ 6.60	1999, 08/04
Pacific Aerospace & Electronics* (units)	146,700	$ 3.75	2001, 07/15
Pearce Systems International, Inc.* (units)	47,722	$ 8.70	1999, 02/11
Premium Cigars International, Ltd.*	2,000	$ 8.40	2002, 08/21
R-B Rubber Products, Inc.*	55,100	$ 5.10	2000, 05/10
Sparta Surgical Corp.* (units)	11,221	$ 12.00	1999, 07/12
Supergen, Inc. (units) ERC 3-12-97	268,950	$ 7.20	2001, 03/12
Telepartners A/S* (units)	102,437	$ 6.00	2002, 06/30
WSG Systems, Inc.*	11.0260	$ 6,000.00	2003, 03/31

</Table>

*Warrants valued at $0.00

<Page>

Schedule II

Paulson Capital Corp. and Subsidiary

Valuation and Qualifying Accounts

Years ended December 31, 1999, 1998 and 1997

<Table>
<Caption>

Description	Balance Beginning of Year	Additions-Charges to Cost and Expenses	Deductions Write-offs	Balance at End of Year
<S>	<C>	<C>	<C>	<C>
Allowance for doubtful accounts:				
Year ended Dec. 31, 1999	$ 267,193	$ -	$ 267,193	$ -
Year ended Dec. 31, 1998	-	267,193	$ -	$ 267,193
Year ended Dec. 31, 1997	-	-		-

</Table>

<Page>

SIGNATURES

Pursuant to the requirements of Section 13 or 15 of the Securities and Exchange Act of 1934, the Registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

Paulson Capital Corp.

Date: August 3, 2001 By: /s/ CHESTER L.F. PAULSON

Chester L.F. Paulson
President