

B. Riley Financial, Inc.
Form 10-K
March 06, 2019

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

FORM 10-K

(Mark
One)

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

For the fiscal year ended December 31, 2018

Or

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 001-37503

B. RILEY FINANCIAL, INC.
(Exact name of registrant as specified in its charter)

Delaware

27-0223495

(State or Other Jurisdiction of

(I.R.S. Employer Identification No.)

Incorporation or Organization)

21255 Burbank Boulevard, Suite 400

Woodland Hills, CA

91367

(Address of Principal Executive Offices) (Zip Code)

(818) 884-3737

(Registrant's telephone number, including area code)

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

Common Stock, par value \$0.0001 per share

7.25% Senior Notes due 2027

7.50% Senior Notes due 2027

7.375% Senior Notes due 2023

6.875% Senior Notes due 2023

7.50% Senior Notes due 2021

(Title of Class)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes: No:

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

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Yes: No:

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: No:

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit such files). Yes: No:

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not 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-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The aggregate market value of the registrant's common stock held by non-affiliates, based on the closing price of the registrant's common stock as reported on the NASDAQ Global Market on June 30, 2018, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$435.1 million. For purposes of this calculation, it has been assumed that all shares of the registrant's common stock held by directors, executive officers

and stockholders beneficially owning ten percent or more of the registrant's common stock are held by affiliates. The treatment of these persons as affiliates for purposes of this calculation is not conclusive as to whether such persons are, in fact, affiliates of the registrant.

The number of shares outstanding of the registrant's common stock as of February 28, 2019 was 26,646,043.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement relating to the registrant's 2019 Annual Meeting of Stockholders are incorporated by reference into Part III of this Annual Report.

B. RILEY FINANCIAL, INC.

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PART I

This Annual Report on Form 10-K (this “Annual Report”) contains forward-looking statements regarding our business, financial condition, results of operations and prospects. Words such as “expect,” “anticipate,” “intend,” “plan,” “believe,” “see,” “may,” “will,” “should,” “could,” “future,” “likely,” “predict,” “project,” “potential,” “continue,” “estimate” and similar expressions generally intended to identify forward-looking statements, but are not exclusive means of identifying forward-looking statements in this Annual Report. You should not place undue reliance on such forward-looking statements, which are based on the information currently available to us and speak only as of the date on which this Annual Report was filed with the Securities and Exchange Commission (the “SEC”). Because these forward-looking statements involve known and unknown risks and uncertainties, there are important factors that could cause actual results, events or developments to differ materially from those expressed or implied by these forward-looking statements, including our plans, objectives, expectations and intentions and other factors discussed in “Part I—Item 1A. Risk Factors” contained in this Annual Report. Risk factors that could cause actual results to differ from those contained in the forward-looking statements include but are not limited to risks related to: volatility in our revenues and results of operations; changing conditions in the financial markets; our ability to generate sufficient revenues to achieve and maintain profitability; the short term nature of our engagements; the accuracy of our estimates and valuations of inventory or assets in “guarantee” based engagements; competition in the asset management business; potential losses related to our auction or liquidation engagements; our dependence on communications, information and other systems and third parties; potential losses related to purchase transactions in our Auction and Liquidations business; potential significant liability and harm to our reputation if we are required to pay the termination fee or other obligations of Vintage Capital in connection with the ongoing litigation with Rent-A-Center, the potential loss of financial institution clients; potential losses from or illiquidity of our proprietary investments; changing economic and market conditions; potential liability and harm to our reputation if we were to provide an inaccurate appraisal or valuation; potential mark-downs in inventory in connection with purchase transactions; failure to successfully compete in any of our segments; loss of key personnel; our ability to borrow under our credit facilities as necessary; failure to comply with the terms of our credit agreements; our ability to meet future capital requirements; our ability to realize the benefits of our completed and proposed acquisitions, including our ability to achieve anticipated opportunities and operating cost savings, and accretion to reported earnings estimated to result from completed and proposed acquisitions in the time frame expected by management or at all; our ability to promptly and effectively integrate our business with that of magicJack; the reaction to the magicJack acquisition of our and magicJack’s customers, employees and counterparties; and the diversion of management time on acquisition-related issues. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Except as otherwise required by the context, references in this Annual Report to “the Company,” “B. Riley,” “B. Riley Financial,” “we,” “us” or “our” refer to the combined business of B. Riley Financial, Inc. and all of its subsidiaries.

Item 1. BUSINESS

General

B. Riley Financial, Inc. (NASDAQ: RILY) and its subsidiaries provide collaborative financial services and solutions through several operating subsidiaries including:

B. Riley FBR, Inc. (“B. Riley FBR”) is a leading, full service investment bank providing financial advisory, corporate finance, research, securities lending and sales and trading services to corporate, institutional and high net worth individual clients. B. Riley FBR was formed in November 2017 through the merger of B. Riley & Co, LLC and FBR Capital Markets & Co., which the Company acquired in June 2017; the name of the combined broker dealer was subsequently changed to B. Riley FBR, Inc.

B. Riley Wealth Management, Inc provides comprehensive wealth management and brokerage services to individuals and families, corporations and non-profit organizations, including qualified retirement plans, trusts, foundations and endowments. B. Riley Wealth Management was formerly Wunderlich Securities, Inc., which the Company acquired on July 3, 2017 and changed the name in June 2018.

B. Riley Capital Management, LLC, a Securities and Exchange Commission (“SEC”) registered investment advisor, which includes:

o B. Riley Asset Management, an advisor to certain private funds and to institutional and high net worth investors;

Great American Capital Partners, LLC (“GACP”), the general partner of two private funds, GACP I, L.P. and GACP oII, L.P., both direct lending funds that provide senior secured loans and second lien secured loan facilities to middle market public and private U.S. companies.

GlassRatner Advisory & Capital Group LLC (“GlassRatner”), a specialty financial advisory services firm that provides consulting services to shareholders, creditors and companies, including due diligence, fraud investigations, corporate litigation support, crisis management and bankruptcy services. We acquired GlassRatner on August 1, 2018. GlassRatner strengthens B. Riley’s diverse platform and compliments the restructuring services provided by B. Riley FBR.

Great American Group, LLC, a leading provider of asset disposition and auction solutions to a wide range of retail and industrial clients.

Great American Group Advisory and Valuation Services, LLC, a leading provider of appraisal and valuation services for asset based lenders, private equity firms and corporate clients.

We also pursue a strategy of investing in or acquiring companies which we believe have attractive investment return characteristics. We acquired United Online, Inc. (“UOL”) on July 1, 2016 and magicJack VocalTec Ltd. (“magicJack”) on November 14, 2018 as part of our principal investment strategy.

UOL is a communications company that offers consumer subscription services and products, consisting of Internet access services and devices under the NetZero and Juno brands primarily sold in the United States.

magicJack is a Voice over IP (“VoIP”) cloud-based technology and services communications provider.

We are headquartered in Los Angeles with offices in major cities throughout the United States including New York, Chicago, Boston, Dallas, Memphis, Metro Washington D.C and West Palm Beach.

For financial reporting purposes we classify our businesses into four operating segments: (i) Capital Markets, (ii) Auction and Liquidation, (iii) Valuation and Appraisal and (iv) Principal Investments - United Online and magicJack.

Capital Markets Segment. Our Capital Markets segment provides a full array of investment banking, corporate finance, consulting, financial advisory, research, securities lending, wealth management and sales and trading services to corporate, institutional and high net worth clients. Our corporate finance and investment banking services include merger and acquisitions as well as restructuring advisory services to public and private companies, initial and secondary public offerings, and institutional private placements. In addition, we trade equity securities as a principal for our account, including investments in funds managed by our subsidiaries. Our Capital Markets segment also includes our asset management businesses that manage various private and public funds for institutional and individual investors.

Auction and Liquidation Segment. Our Auction and Liquidation segment utilizes our significant industry experience, a scalable network of independent contractors and industry-specific advisors to tailor our services to the specific needs of a multitude of clients, logistical challenges and distressed circumstances. Furthermore, our scale and pool of resources allow us to offer our services across North American as well as parts of Europe, Asia and Australia. Our Auction and Liquidation segment operates through two main divisions, retail store liquidations and wholesale and industrial assets dispositions. Our wholesale and industrial assets dispositions division operates through limited liability companies that are controlled by us.

Valuation and Appraisal Segment. Our Valuation and Appraisal segment provides Valuation and Appraisal services to financial institutions, lenders, private equity firms and other providers of capital. These services primarily include the valuation of assets (i) for purposes of determining and monitoring the value of collateral securing financial transactions and loan arrangements and (ii) in connection with potential business combinations. Our Valuation and Appraisal segment operates through limited liability companies that are majority owned by us.

Principal Investments - United Online and magicJack Segment. Our Principal Investments - United Online and magicJack segment consists of businesses which have been acquired primarily for attractive investment return characteristics. Currently, this segment includes UOL, through which we provide consumer Internet access, and magicJack, through which we provide VoIP communication and related product and subscription services.

Recent Developments

On June 17, 2018, B. Riley Financial, Inc. (the “Company” or “B. Riley”) entered into certain agreements pursuant to which B. Riley agreed to provide certain debt and equity funding and other support in connection with the acquisition (the “Acquisition”) by Vintage Rodeo Parent, LLC (the “Vintage Parent”), of Rent-A-Center, Inc. (“Rent-A-Center”), contemplated by that certain merger agreement dated as of June 17, 2018, by and among Vintage Parent, Vintage Rodeo Acquisition, Inc. a wholly owned subsidiary of Vintage Parent (the “Merger Sub” or the “Borrower”), and Rent-A-Center (the “Merger Agreement”).

In connection therewith, B. Riley and Vintage RTO, L.P., an affiliate of Vintage Parent (“Vintage Merger Guarantor”), entered into a Limited Guarantee dated as of June 17, 2018 (the “Limited Guarantee”), in favor of Rent-A-Center, pursuant to which B. Riley and Vintage Merger Guarantor (together, the “Merger Guarantors”) agreed to guarantee, jointly and severally, to Rent-A-Center the payment, performance and discharge of all of the liabilities and obligations of Vintage Parent and Merger Sub under the Merger Agreement when required in accordance with the Merger Agreement (the “Guaranteed Obligations”), including without limitation, (i) termination fees in the amount of \$126.5 million due to Rent-A-Center if the Merger Agreement is properly terminated (the “Termination Fee”); and (ii) reimbursement and indemnification obligations when required (collectively, the “Guarantee Obligations”), provided, that the liability under the Limited Guarantee shall not exceed \$128.5 million.

In connection with the execution of the Limited Guarantee, the Company entered into a Mutual Indemnity/Contribution Agreement, dated as of June 17, 2018 (the “Mutual Indemnity Agreement”), with the Vintage Merger Guarantor and Samjor Family, LP (collectively, the “Vintage Indemnity Parties”). Under the Mutual Indemnity Agreement, the Vintage Guarantors agreed, jointly and severally, to indemnify and hold harmless B. Riley and its affiliates from damages and liabilities arising out of the Guarantee Obligations, other than those caused B. Riley’s failure to fund under their debt or equity commitments.

On December 18, 2018, Rent-A-Center purported to terminate the Merger Agreement because the end date of the agreement was allegedly not extended prior to December 17, 2018 by Vintage Parent. Rent-A-Center delivered notice of such termination to Vintage Parent, and notified Vintage Parent of its obligation under the terms of the Merger Agreement to pay Rent-A-Center the Termination Fee within three business days.

On December 18, 2018, Vintage Capital Management, LLC, an affiliate of Vintage Parent (“Vintage Capital”), delivered a letter to Rent-A-Center stating that Rent-A-Center’s purported termination of the Merger Agreement is invalid, that it believes the Merger Agreement remains in effect. On December 21, 2018, Vintage Capital filed a complaint in the Court of Chancery of the State of Delaware (the “Court”) challenging Rent-A-Center’s purported termination of the Merger Agreement and demand for payment of the Termination Fee. The relief sought by Vintage Capital includes declaratory judgements that the Merger Agreement has not been terminated and remains in full force and effect, that Rent-A-Center has breached its obligations under the Merger Agreement and is not excused from failing to comply with its obligations thereunder and that the Termination Fee is an unenforceable penalty.

On December 28, 2018, Rent-A-Center provided each of B. Riley and the Vintage Merger Guarantors with a written request under the Limited Guarantee (a “Performance Demand”), to promptly, and in any event within ten (10) Business Days, pay to Rent-A-Center the Guaranteed Obligations (including the Termination Fee) in full.

On December 30, 2018, B. Riley filed a motion in the Court to intervene in the above referenced case filed by Vintage Capital pursuant to which B. Riley is seeking declaratory judgments, among other things, that the parties agreed to

extend the End Date under the Merger Agreement and that Rent-A-Center is estopped from terminating the Merger Agreement, that Rent-A-Center has breached the Merger Agreement and its obligations of good faith and fair dealing in connection with consummating the Merger, and that the Termination Fee is an unenforceable penalty. B. Riley is also seeking an award of costs and reasonable attorneys' fees and such other further relief as the Court finds equitable and appropriate.

At a hearing held on December 31, 2018, the Court stated that it would grant a temporary restraining order to preserve the status quo, which order would prohibit Rent-A-Center from engaging in certain transactions pending an expedited trial on the merits. On January 3, 2019, the Court granted B. Riley's motion to intervene in the Vintage Capital case and on January 7, 2019, the Court granted a temporary restraining order restricting Rent-A-Center from engaging in certain transactions prior to the trial on the merits scheduled for February 11, 2019. On February 11th and 12th, a trial was held in Delaware, post-trial briefs were filed on February 22, 2019 and March 1, 2019. A post-trial hearing has been scheduled for March 11, 2019. The Company believes that it is reasonably possible that the Court will rule in favor of the Performance Demand. The amount of possible loss is not estimable; however, the range of loss could be from \$0 to \$128.5 million.

On November 14, 2018, the Company entered into an agreement to acquire shares of National Holdings Corporation ("National Holdings"), a Nasdaq-listed issuer, from Fortress Biotech, Inc. for an aggregate purchase price totaling approximately \$22.9 million. The transaction was completed in two tranches. In the first tranche, which was completed in the fourth quarter of 2018, the Company acquired shares representing 24% of the total outstanding shares of National Holdings. The second tranche was contingent upon receipt of the approval of Financial Industry Regulatory Authority, Inc., which was obtained in the first quarter of 2019. As a result of the closing of the second tranche, the Company now holds 49% of the outstanding shares of National Holdings. The equity ownership in National Holdings is accounted for under the equity method of accounting.

BRPI Acquisition Co LLC, a Delaware corporation (“BRPAC”), UOL, and YMax Corporation, a Delaware corporation (“YMax”; and, together with BRPAC and UOL, the “Borrowers”), our indirect wholly-owned subsidiaries, in their capacity of borrowers, entered into a credit agreement (the “BRPAC Credit Agreement”) dated December 19, 2018, with the Banc of California, N.A. in its capacity as agent and lender and with the other lenders party thereto. Certain of the Borrowers’ U.S. subsidiaries are guarantors of all obligations under the BRPAC Credit Agreement and are parties to the BRPAC Credit Agreement in such capacity (collectively, the “Secured Guarantors”; and, together with the Borrowers, the “Credit Parties”). In addition, we and B. Riley Principal Investments, LLC, the parent corporation of BRPAC and our subsidiary, are guarantors of the obligations under BRPAC Credit Agreement pursuant to standalone guaranty agreements pursuant to which the shares of outstanding membership interests of the BRPAC are pledged as collateral. The obligations under the BRPAC Credit Agreement are secured by first-priority liens on, and a first-priority security interest in, substantially all of the assets of the Credit Parties, including a pledge of (a) 100% of the equity interests of the Credit Parties, (b) 65% of the equity interests in United Online Software Development (India) Private Limited, a private limited company organized under the laws of India and (c) 65% of the equity interests in magicJack. The credit facilities under the BRPAC Credit Agreement consist of: (a) a term credit facility under which the Borrowers may borrow up to \$80.0 million on the closing date with a final maturity date of five years from the closing date; and (b) an optional accordion term loan credit facility under which the Borrowers may borrow up to \$10.0 million with a final maturity date of five years from the closing date. On February 1, 2019, the Borrowers entered into the First Amendment to Credit Agreement and Joinder with City National Bank as a new lender in which the new lender extended to Borrowers the additional \$10.0 million as further discussed in Note 11 to the accompanying financial statements. Borrowings under the BRPAC Credit Agreement are due in quarterly installments commencing on March 31, 2019 with any remaining amounts outstanding due at maturity. The borrowings under the BRPAC Credit Agreement bear interest equal to the LIBOR plus a margin of 2.50% to 3.00% depending on the Borrowers’ consolidated total funded debt ratio as defined in the BRPAC Credit Agreement. The proceeds of the BRPAC Credit Agreement were used to refinance a portion of the purchase price of the recently closed acquisition of magicJack and to pay related costs. Borrowings under the BRPAC Credit Agreement will bear interest at a rate equal to (A) the LIBOR Rate for Eurodollar loans, plus (B) the applicable margin rate, which ranges from two and one-half percent (2.5%) to three percent (3.0%) per annum. Amounts outstanding under the Credit Facilities are due in quarterly installments commencing on March 31, 2019 with any remaining amounts outstanding due at maturity.

On September 6, 2018, we entered into an underwriting agreement (the “Underwriting Agreement”) with B. Riley FBR, as representative of several underwriters named in the Underwriting Agreement, pursuant to which we agreed to sell to the underwriters up to an aggregate principal amount of \$87.0 million of the 6.875% Senior Notes due September 2023 (the “6.875% 2023 Notes”), plus an additional \$13.1 million aggregate principal amount to cover underwriter overallotments. As of December 31, 2018, we have sold approximately \$100.1 million of the 6.875% 2023 Notes. The 6.875% 2023 Notes were issued pursuant to the Indenture between us and U.S. Bank, National Association, as trustee. The 6.875% 2023 Notes sold under the Underwriting Agreement were issued pursuant to a prospectus dated April 6, 2018, as supplemented by a prospectus supplement dated September 7, 2018, each filed with the SEC pursuant to the Company’s effective Registration Statement on Form S-3 (File No. 333-223789), which was declared effective by the SEC on April 6, 2018.

During 2017 and 2018, we entered into a series of related At the Market Issuance Sales Agreements (the “Sales Agreements”) with B. Riley FBR, Inc. governing an ongoing program of at-the-market sales of our senior notes. We filed prospectus supplements under which we sold the senior notes on June 28, 2017, December 19, 2017, April 25,

2018, June 5, 2018 and December 18, 2018. Each of these prospectus supplements was filed pursuant to an effective Registration Statement on Form S-3. In aggregate, we have sold senior notes having an aggregate principal balance of \$467.2 million under the Sales Agreements and related prospectus supplements. Our most recent Sales Agreement was entered into on December 18, 2018 (the “December 2018 Program”), and, under the related prospectus supplement, we may offer and sell up to \$75.0 million of the senior notes. As of December 31, 2018, we had \$75.0 million remaining availability under the December 2018 Program.

On April 18, 2018, the United States Bankruptcy Court for the District of Delaware issued an order (the “Order”) approving the sale of certain rights to the assets of The Bon-Ton Stores, Inc. and its affiliates (the “Debtors”) and granted certain other relief to GA Retail, Inc. (“GA”), an indirect wholly owned subsidiary of the Company, Tiger Capital Group, LLC (“Tiger”), and the indenture trustee (the “Indenture Trustee”; together with GA and Tiger, the “Joint Venture”) under the Second Lien Indenture (as defined in the Order). Among other things, the Order approved the Joint Venture’s right to act as the Debtors’ exclusive agent to conduct the sale of substantially all of the Debtors’ assets on the terms and conditions set forth in that certain agency agreement dated April 18, 2018 by and among the Debtors and the Joint Venture (the “Agency Agreement” and the related transactions, the “Bon-Ton Transactions”).

Pursuant to the Agency Agreement, the Joint Venture agreed to pay (a) a cash purchase price of approximately \$560.0 million (the “Cash Purchase Price”), which includes all amounts due and owing by the Debtors to the lenders under that certain debtor in possession financing facility, the cash amounts used to collateralize certain letters of credit and an amount to fund the payment of certain fees and expenses incurred by the Debtors’ professionals, (b) a credit bid of \$125.0 million, and (c) \$93.8 million to pay for certain administrative expenses of the Debtors as reflected in an agreed upon wind down budget. In exchange for such payments and the payment of certain expenses, the Joint Venture received the right to receive all proceeds (cash or otherwise) of any of the Debtors’ Assets except as otherwise set forth in the Agency Agreement (the “Proceeds”). The sale of inventory and certain of the assets of Bon-Ton through a going-out-of-business sale was completed on August 31, 2018. The Joint Venture continues to wind down the business activities of Bon-Ton and sale of certain real property, among other items, in accordance with the Agency Agreement.

To fund GA’s portion of the Cash Purchase Price, GA borrowed (i) \$300.0 million from Wells Fargo Bank, N.A. (“Wells Fargo Bank”) pursuant to an amended and restated consent dated April 19, 2018 to that certain credit agreement among GA, its affiliates and Wells Fargo Bank, as amended (the “Credit Agreement”), and (ii) approximately \$51.0 million from GACP II, L.P., a direct lending fund managed by GACP, an affiliate of GA and a wholly owned subsidiary of the Company. Each of these loans is to be repaid from the Proceeds after the payment of certain expenses incurred by the Joint Venture in connection with the sale. In connection with the borrowing from Wells Fargo Bank, the maximum borrowing limit under the Credit Agreement was increased solely for purposes of the Bon-Ton Transactions from \$200.0 million to \$300.0 million and reverted back to \$200.0 million upon repayment of the amounts borrowed in connection with the Bon-Ton Transactions. The amounts borrowed in connection with the Bon-Ton Transaction were fully repaid in the third quarter of 2018.

On March 15, 2018, we were a party to a Secondary Stock Purchase Agreement with ACP BD Investments, LLC (“ACP”) which required us to purchase 950,000 shares of our common stock at \$18.25 per share or approximately \$17.3 million in cash. The stock was repurchased from ACP on April 2, 2018 and we retired the shares.

On January 12, 2018, we converted a loan receivable from bebe stores, inc. (“bebe”) in the amount of \$16.9 million in principal and accrued interest into 2,819,528 shares of common stock of bebe, representing a conversion price at \$6.00 per share. On January 12, 2018, we also purchased 500,000 shares of bebe common stock at \$6.00 per share of which

250,000 shares were newly issued common stock by bebe and 250,000 shares were purchased from the majority shareholder of bebe. In total, we acquired 3,319,528 shares of bebe common stock. In connection with such transactions, bebe fixed the size of its board of directors at five members of which two employees of we were newly appointed to the bebe board. At December 31, 2018, we had an ownership of approximately 30.1% of bebe's outstanding common shares.

On November 9, 2017, we entered into an Agreement and Plan of Merger (the "magicJack Merger Agreement") with B. R. Acquisition Ltd., an Israeli corporation and wholly-owned subsidiary of the ours ("Merger Sub"), and magicJack VocalTec Ltd., an Israeli corporation ("magicJack"), pursuant to which Merger Sub will merge with and into magicJack, with magicJack continuing as the surviving corporation and as an indirect subsidiary of ours. Subject to the terms and conditions of the magicJack Merger Agreement, each outstanding share of magicJack converted into the right to receive \$8.71 in cash without interest, representing approximately \$143.1 million in aggregate merger consideration. The closing of the transaction was subject to the receipt of certain regulatory approvals and the satisfaction of other closing conditions. The acquisition of magicJack closed in November of 2018.

Our Business

B. Riley FBR

Investment Banking and Corporate Finance

B. Riley FBR's investment banking professionals provide equity and debt capital raising, merger and acquisition, financial advisory and restructuring advisory services to both private and publicly traded companies. Those services include: follow-on public offerings, debt and equity private placements, debt refinancing, corporate debt and equity security repurchases, and buy-side and sell-side representation, divestitures/carveouts, leveraged buyouts, management buyouts, strategic alternatives reviews, fairness opinions, valuations, return-of-capital advisory, hostile/activist advisory, and options trading programs.

Sales, Trading and Corporate Services

Our sales and trading professionals distribute B. Riley proprietary research products to our institutional investor clients and high net worth individuals. B. Riley FBR sales and trading also sells the securities of companies in which B. Riley FBR acts as an underwriter and executes equity trades on behalf of clients. We maintain active trading relationships with substantially all major institutional money managers. Our equity and fixed income traders make markets in approximately 150 securities. B. Riley FBR also conducts securities lending activities which involves the borrowing and lending of equity and fixed income securities. Our corporate services include retail orders, block trades, Rule 144 transactions, cashless exercise of options, and corporate equity repurchase programs.

Equity Research

Our equity research is focused on fundamentals-based research. Our research focuses on an in-depth analysis of earnings, cash flow trends, balance sheet strength, industry outlook, and strength of management that involves extensive meetings with key management, competitors, channel partners and customers. We provide research on all sizes of firms; however, our research primarily focuses on small and mid-cap stocks that are under-followed by Wall Street. Our analysts regularly communicate their findings through Research Updates and daily Morning Notes.

Our research department includes research analysts maintaining coverage on a variety of companies in a variety of industry sectors. Our research department annually organizes non-deal road shows for issuers in our targeted industries. To provide our institutional clients access to management teams of companies in our coverage universe and others, our research department has held 18 consecutive annual institutional investor conferences.

Capital Management

We provide investment management services under our subsidiary, B. Riley Capital Management, LLC, an SEC registered investment advisor. The registered investment advisor manages one mutual fund and certain other private investment funds, including a fund of funds. All of the funds managed typically invest in both public and private equity and debt. Investors in the various funds include institutional, high net worth, and individual investors. GACP is the general partner of GACP I, L.P. and GACP II, L.P., direct lending funds that provide senior secured loans and second lien secured loan facilities to middle market public and private U.S. companies.

Proprietary Trading

We engage in trading activities for strategic investment purposes (i.e. proprietary trading) utilizing the firm's capital. Proprietary trading activities include investments in public and private stock and debt securities. In 2010, the federal government passed the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Dodd-Frank significantly restructures and intensifies regulation in the financial services industry and includes a section referred to as the "Volcker Rule". The Volcker Rule provides for a limitation on proprietary trading and investments by certain bank holding companies. We are not a bank holding company and, as a result, the limitations applicable to bank holding companies regarding proprietary trading and investment in the Volcker Rule do not apply to us.

B. Riley Wealth Management

Wealth Management

B. Riley Wealth Management provides comprehensive wealth management and brokerage services to individuals and families, corporations and non-profit organizations, including qualified retirement plans, trusts, foundations and endowments. Our financial advisors provide a broad range of investments and services to our clients, including financial planning services. Wunderlich Securities, Inc. ("Wunderlich") was established in 1996 and headquartered in Memphis, Tennessee. Wunderlich became a wholly-owned subsidiary of B. Riley Financial, Inc., in July 2017 and its operations are included in our Capital Markets segment. In June 2018, Wunderlich changed its name to B. Riley Wealth Management, Inc.

GlassRatner

Financial Advisory Services

GlassRatner, a specialty financial advisory services firm we acquired on August 1, 2018, provides consulting services to shareholders, creditors and companies, including due diligence, fraud investigations, corporate litigation support, crisis management and bankruptcy services. The addition of GlassRatner strengthens B. Riley's diverse platform and compliments the restructuring services provided by B. Riley FBR.

The business described above for B. Riley FBR, B. Riley Wealth Management and GlassRatner is reported in our Capital Markets segment for financial reporting purposes.

Great American Group

Retail Store Liquidations and Wholesale and Industrial Liquidations

We enable our clients to quickly and efficiently dispose of under-performing assets and generate cash from excess inventory by conducting or assisting in retail store closings, going out of business sales, bankruptcy sales and fixture sales. Financial institution and other capital providers rely on us to maximize recovery rates in distressed asset sales and in retail bankruptcy situations. Additionally, healthy, mature retailers utilize our proven inventory management and strategic disposition solutions, relying on our extensive network of retail professionals, to close unproductive stores and dispose of surplus inventory and fixtures as existing stores are updated.

We often conduct large retail liquidations that entail significant capital requirements through collaborative arrangements with other liquidators. By entering into an agreement with one or more collaborators, we are able to bid on larger engagements that we could not conduct on our own due to the significant capital outlay involved, number of independent contractors required or financial risk associated with the particular engagement. We act as the lead partner in many of the collaborative arrangements that we enter into, meaning that we have primary responsibility for the due diligence, contract negotiation and execution of the engagement.

We design and implement customized disposition programs for our clients seeking to convert excess wholesale and industrial inventory and operational assets into capital. We dispose of a wide array of assets including, among others, equipment related to transportation, heavy mobile construction, energy exploration and services, metal fabrication, food processing, semiconductor fabrication, and distribution services. We manage projects of all sizes and scopes across a variety of asset categories. We believe that our databases of information regarding potential buyers that we have collected from past transactions and engagements, our nationwide name recognition and experience with alternative distribution channels allow us to provide superior wholesale and industrial disposition services.

Great American Group provides the foregoing services to clients on a guarantee, fee or outright purchase basis.

Guarantee. When providing services on a guarantee basis, we guarantee the client a specific recovery often expressed as a percentage of retail inventory value or wholesale inventory cost or, in the case of machinery or equipment, a set dollar amount. This guarantee is often required to be supported by a letter of credit, a cash deposit or a combination thereof. Cash deposits are typically funded in part with available cash together with short term borrowings under our credit facilities. Often when we provide auction or liquidation services on a guarantee basis, we do so through a collaborative arrangement with other service providers. In this situation, each collaborator agrees to provide a certain percentage of the guaranteed amount to the client through a combination of letters of credit, cash and financing. If we

are engaged individually, we receive 100% of the net profit, less debt financing fees, sale related expenses (if any) and any share of the profits due to the client as a result of any profit sharing arrangement entered into based on a pre-negotiated formula. If the engagement was conducted through a collaborative arrangement, the profits or losses are divided among us and our partner or partners as set forth in the agreement governing the collaborative arrangement. If the net sales proceeds after expenses are less than the guarantee, we, together with our partners if the engagement was conducted through a collaborative arrangement, are responsible for the shortfall and will recognize a loss on the engagement.

Fee. When we provide services on a fee basis, clients pay a pre-negotiated flat fee for the services provided, a percentage of asset sales generated or a combination of both.

Outright Purchase. When providing services on an outright purchase basis, we purchase the assets from the client and typically sell them at auction, orderly liquidation, through a third-party broker or, less frequently, as augmented inventory in conjunction with another liquidation that we are conducting. In an outright purchase, we take, together with any collaboration partners, title to the assets and absorb the profit or loss associated with the asset disposition.

The retail store liquidations and wholesale and industrial asset dispositions business of Great American Group described above is reported in our Auction and Liquidation segment for financial reporting purposes.

Valuation and Appraisal

Our Valuation and Appraisal teams provide independent appraisals to financial institutions, lenders, private equity firms and other providers of capital for estimated liquidation values of assets. These teams include experts specializing in particular industry niches and asset classes. We provide Valuation and Appraisal services across five general categories:

Consumer and Retail Inventory. Representative types of appraisals and valuations include inventory of specialty apparel retailers, department stores, jewelry retailers, sporting goods retailers, mass and discount merchants, home furnishing retailers and footwear retailers.

Wholesale and Industrial Inventory. Representative types of appraisals and valuations include inventory held by manufacturers or distributors of automotive parts, chemicals, food and beverage products, wine and spirits, building and construction products, industrial products, metals, paper and packaging.

Machinery and Equipment. Representative types of asset appraisals and valuations include a broad range of equipment utilized in manufacturing, construction, transportation and healthcare.

Intangible Assets. Representative types of asset appraisals and valuations include intellectual property, goodwill, brands, logos, trademarks and customer lists.

We provide Valuation and Appraisal services on a pre-negotiated flat fee basis.

The Valuation and Appraisal services business of Great American Group described above is reported in our Valuation and Appraisal segment for financial reporting purposes.

Principal Investments - United Online and magicJack

We acquired UOL on July 1, 2016 and magicJack on November 14, 2018 as part of our principal investment strategy. UOL's primary pay service is Internet access, offered under the NetZero and Juno brands. Internet access includes dial-up service, mobile broadband and DSL. magicJack is a VoIP cloud-based technology and services communications provider and the inventor of the magicJack devices.

Internet Access

Our Internet access services consist of dial-up, mobile broadband and, to a much lesser extent, DSL services. Our dial-up Internet access services are provided on both a free and pay basis, with the free services subject to hourly and other limitations. Basic pay dial-up Internet access services include accelerated dial-up Internet access and an email account. Our Internet access services are also bundled with additional benefits, including antivirus software and enhanced email storage, although we also offer each of these features and certain other value-added features as stand-alone pay services. We offer mobile broadband devices for sale in connection with our mobile broadband services. We also generate revenues from the resale of telecommunications to third parties. Over the past several years revenues from paid subscription services have declined year over year as a result of a decline in the number of paid subscribers for our services. Management believes the decline in paid subscriber accounts is primarily attributable to the industry trends of consumers switching from dial-up Internet access to high speed Internet access such as cable and DSL. Management expects revenues in the Principal Investments - United Online and magicJack segment to continue to decline year over year.

magicJack Devices

The magicJack is a VoIP device weighing about one ounce which includes an initial access right period. During the initial access right period customers receive free VoIP phone service for their home, business or while traveling to call anywhere in the United States and Canada. The initial access right period for the different versions of the device have ranged from three to twelve months. The current device available for purchase is the magicJack GO, which includes a twelve month access right period. magicJack devices are sold either directly to customers through our website or through retailers.

Mobile apps

The Company also offers the magicApp and magicJack Connect mobile apps, which are applications that allow users to make and receive telephone calls through their smart phones or devices. The magicApp and magicJack Connect are mobile apps available for both iOS and Android. The mobile apps allow customers to place and receive telephone calls in the U.S. or Canada on their mobile devices through either an existing or new magicJack account. The mobile apps also give users the ability to add a second phone number to their smart phone for a monthly or annual fee. Customers may purchase international minutes to place telephone calls through the magicJack device or mobile apps to locations outside of the U.S. and Canada.

Access Right Renewals

Customers who own a magicJack device or mobile app may renew access rights for periods ranging from one month to three years.

Other magicJack-Related Products

The Company offers customers other optional products related to their magicJack devices and services, such as custom or vanity phone numbers, Canadian phone numbers and the ability to either change their existing phone numbers or port them to a magicJack device.

Prepaid Minutes

The Company's customers can purchase international minutes on a prepaid basis.

Access and Wholesale Charges

The Company generates revenues from access and termination fees charged to other carriers, as well as wholesaling telephone service to VoIP providers and telecommunication carriers.

UCaaS Services and Equipment

The Company provides hosted communication services and sells hardware and network equipment that are compatible with the service, through its subsidiary, Broadsmart Global, Inc. ("Broadsmart"), which has a track record of provisioning and delivering complex Unified Communication as a Service ("UCaaS") solutions to blue chip corporate customers on a nationwide basis.

Advertising and other revenue

Advertising and other revenues are primarily derived from various advertising, marketing and media-related initiatives. The majority of our advertising and other revenues include advertising revenues from search placements, display advertisements and online market research associated with our Internet access and email services.

The business described above for UOL and magicJack is reported in our Principal Investments — UOL and magicJack segment.

Customers

We serve retail, corporate, capital provider and individual customers across our services lines. The services provided to these customers were under short-term liquidation contracts that generally do not exceed a period of six months. There were no recurring revenues from year-to-year in connection with the services we performed under these contracts.

B. Riley FBR

We are engaged by corporate customers, including publicly held and privately owned companies, to provide investment banking, corporate finance, restructuring advisory, research and sales and trading services. We also provide corporate finance, research, wealth management, and sales and trading services to high net worth individuals. We maintain client relationships with companies in the consumer goods, consumer services, defense, industrials and technology industries.

B. Riley Wealth Management

We act as financial wealth management advisors to individuals, families, small businesses, non-profit organizations, and qualified retirement plans. Our investment services are primarily comprised of asset management services to meet the financial plans, financial goals and needs of our customers. We service our customers through a network of 20 branch offices located in 13 states primarily located in the Mid-west and Southern section of the United States.

GlassRatner

We provide specialty financial advisory services to companies, shareholders, creditors and investors on complex business problems and critical board level agenda items including transaction advisory and due diligence, fraud investigations, corporate litigation, business valuations, crisis management and bankruptcy. We provide bankruptcy and restructuring services, forensic accounting and litigation support, valuation services, and real estate consulting.

Great American Group

Our retail Auction and Liquidation clients include financially healthy retailers as well as distressed retailers, bankruptcy professionals, financial institution workout groups and a wide range of professional service providers. Some retail segments in which we specialize include apparel, arts and crafts, department stores, discount stores, drug / health and beauty, electronics, footwear, grocery stores, hardware / home improvement, home goods and linens, jewelry, office / party supplies, specialty stores, and sporting goods. We also provide wholesale and industrial auction services and customized disposition programs to a wide range of clients.

We are engaged by financial institutions, lenders, private equity firms and other capital providers, as well as professional service providers, to provide valuation and advisory services. We have extensive experience in the appraisal and valuation of retail and consumer inventories, wholesale and industrial inventories, machinery and equipment, intellectual property and real estate. We maintain ongoing client relationships with major asset based lenders including Bank of America, JPMorgan Chase, and Wells Fargo.

United Online

Our Internet access services are available to customers, which are primarily comprised of individuals, in more than 12,000 cities across the U.S. and Canada. Generally, our Internet access customers also subscribe to value-added features that include antivirus software and enhanced email storage. Our advertising customers primarily include business customers that market products and services over the Internet.

magicJack

magicJack provides complete VoIP phone service for home, business and while traveling. We sell services through retailers, wholesalers or directly to consumers over the Internet in the United States and Canada. The Company has experience provisioning and delivering complex UCaaS solutions to corporate customers on a nationwide basis and it services multi-location, geographically diverse enterprises. The Company provides customers with an ability to make and receive telephone calls through their smart phones, add a second phone number to their smart phone and purchase prepaid minutes to place telephone calls through the magicJack device or mobile apps to locations outside of the U.S. and Canada.

Competition

B. Riley FBR, B. Riley Wealth Management and GlassRatner

We face intense competition for our Capital Markets services. Since the mid-1990s, there has been substantial consolidation among U.S. and global financial institutions. In particular, a number of large commercial banks, insurance companies and other diversified financial services firms have merged with other financial institutions or have established or acquired broker-dealers. During 2008, the failure or near-collapse of a number of very large financial institutions led to the acquisition of several of the most sizeable U.S. investment banking firms, consolidating the financial industry to an even greater extent. Currently, our competitors are other investment banks,

bank holding companies, brokerage firms, merchant banks and financial advisory firms. Our focus on our target industries also subjects us to direct competition from a number of specialty securities firms and smaller investment banking boutiques that specialize in providing services to these industries.

The industry trend toward consolidation has significantly increased the capital base and geographic reach of many of our competitors. Our larger and better-capitalized competitors may be better able than we are to respond to changes in the investment banking industry, to recruit and retain skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally. Many of these firms have the ability to offer a wider range of products than we do, including loans, deposit-taking and insurance, in addition to brokerage, asset management and investment banking services, all of which may enhance their competitive position relative to us. These firms also have the ability to support investment banking and securities products with commercial banking, insurance and other financial services revenues in an effort to gain market share, which could result in downward pricing pressure in our businesses. In particular, the trend in the equity underwriting business toward multiple book runners and co-managers has increased the competitive pressure in the investment banking industry and has placed downward pressure on average transaction fees.

As we seek to expand our asset management business, we face competition in the pursuit of investors for our investment funds, in the identification and completion of investments in attractive portfolio companies or securities, and in the recruitment and retention of skilled asset management professionals.

Great American Group

We also face intense competition in our other service areas. While some competitors are unique to specific service offerings, some competitors cross multiple service offerings. A number of companies provide services or products to the Auction and Liquidation and Valuation and Appraisal markets, and existing and potential clients can, or will be able to, choose from a variety of qualified service providers. Some of our competitors may even be able to offer discounts or other preferred pricing arrangements. In a cost-sensitive environment, such arrangements may prevent us from acquiring new clients or new engagements with existing clients. Some of our competitors may be able to negotiate secure alliances with clients and affiliates on more favorable terms, devote greater resources to marketing and promotional campaigns or to the development of technology systems than us. In addition, new technologies and the expansion of existing technologies with respect to the online auction business may increase the competitive pressures on us. We must also compete for the services of skilled professionals. There can be no assurance that we will be able to compete successfully against current or future competitors, and competitive pressures we face could harm our business, operating results and financial condition.

We face competition for our retail services from traditional liquidators as well as Internet-based liquidators such as overstock.com and eBay. Our wholesale and industrial services competitors include traditional auctioneers and fixed site auction houses that may specialize in particular industries or geographic regions as well as other large, prestigious or well-recognized auctioneers. We also face competition and pricing pressure from the internal remarketing groups of our clients and potential clients and from companies that may choose to liquidate or auction assets and/or excess inventory without assistance from service providers like us. We face competition for our Valuation and Appraisal services from large accounting, consulting and other professional

seSIZE="2"> 9.43 9.43 10 293,173 742,958 28,595 1.97 16.33 16.33 10 293,666 744,208 32,680 2.26 14.27 14.27 10 293,281 743,232

Barry McCarthy

16,311 1.13% \$11.25 \$11.25 10 \$115,401 \$292,450 19,421 1.34 9.43 9.43 10 115,176 291,878 11,234 0.78 16.33 16.33 10 115,371 292,3

Thomas Dillon

2,076 0.14% \$11.25 \$11.25 10 \$14,688 \$37,222 2,472 0.17 9.43 9.43 10 14,660 37,152 1,430 0.10 16.33 16.33 10 14,686 37,217 1,634 0

Name	Individual Grants					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term	
	Number of Securities Underlying Options Granted	% of Total Options Granted to Employees in Last Fiscal Year (1)	Exercise Price	FMV at time of Grant	Term in Years	5%	10%
Leslie J. Kilgore	14,828	1.02%	\$ 11.25	\$ 11.25	10	\$ 104,909	\$ 265,860
	17,655	1.22	9.43	9.43	10	104,703	265,337
	10,212	0.71	16.33	16.33	10	104,876	265,776
	11,671	0.81	14.27	14.27	10	104,739	265,430
	8,267	0.57	20.16	20.16	10	104,813	265,617
	4,635	0.32	35.95	35.95	10	104,792	265,563
	4,762	0.33	32.60	32.60	10	97,630	247,414
	4,762	0.33	26.90	26.90	10	80,560	204,155
	4,762	0.33	35.36	35.36	10	105,896	268,361
	4,762	0.33	34.75	34.75	10	104,069	263,732
	4,762	0.33	36.37	36.37	10	108,906	275,989
4,762	0.33	27.42	27.42	10	82,102	208,063	

(1) Based on a total of 1,447,940 options granted to employees, including the executive officers, in 2004.

Aggregate Option Exercises in 2004 and Values at December 31, 2004

The following table sets forth information concerning option exercises during 2004 and the exercisable and unexercisable options held by the executive officers as of December 31, 2004. The Value of Unexercised In-the-Money Options at December 31, 2004 column is based on \$12.33, the closing sales price of the Company's common stock on December 31, 2004, less the per share exercise price of the options multiplied by the number of shares issuable upon exercise of the options. All options granted under the 1997 Stock Plan are immediately exercisable upon grant but following any such exercise are subject to repurchase by the Company at cost in the event of the optionee's termination of employment for any reason (including death or disability), to the extent the Company's right of repurchase has not lapsed. The number of shares exercisable that would remain subject to repurchase following an exercise (the unvested portion) is set forth in the footnotes to the following table.

Name	Shares Acquired on Exercise	Value Realized	Number of Securities Underlying Unexercised Options at December 31, 2004		Value of Unexercised In-the-Money Options at December 31, 2004	
			Unexercisable	Exercisable	Unexercisable	Exercisable
Reed Hastings	60,000	\$ 1,710,450		1,511,209(1)	\$	\$ 12,534,401
Barry McCarthy				680,676(2)		5,561,195
Thomas R. Dillon	94,733	2,875,395		135,085(3)		998,959
Leslie J. Kilgore	63,000	1,762,650		407,940(4)		3,137,822

(1) 58,334 shares of which were unvested as of December 31, 2004.

(2) 59,888 shares of which were unvested as of December 31, 2004.

(3) 47,250 shares of which were unvested as of December 31, 2004.

(4) 79,526 shares of which were unvested as of December 31, 2004.

Equity Compensation Plan Information

The following table summarizes the Company's equity compensation plans as of December 31, 2004:

Plan Category	(a) Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	(c) Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (a))
Equity compensation plans or arrangements approved by security holders	13,820,170	\$ 4.22	5,814,951(1)(2)
Equity compensation plans or arrangements not approved by security holders	1,140,000	\$ 1.50	
Total	14,960,170	\$ 4.02	5,814,951

(1) This number of shares includes 1,563,939 shares of the Company's common stock reserved under its 2002 Employee Stock Purchase Plan for future issuance.

(2) The Company's 2002 Stock Plan also provides for annual increases in the number of shares available for issuance on the first day of each year equal to the lesser of: (i) 2,000,000 shares, (ii) 5% of the outstanding shares of the Company's common stock on such date, or (iii) such other amount determined by the Board. In addition, the 2002 Employee Stock Purchase Plan provides for annual increases in the number of shares available for issuance on the first day of each year equal to the lesser of: (i) 666,666 shares, (ii) 2% of the outstanding shares of the Company's common stock on such date, or (iii) such other amount as determined by the Board.

Employment, Severance and Change-of-Control Arrangements

In a change in control transaction, if the options under the Company's amended and restated 1997 Stock Plan are not assumed or substituted for, each outstanding option will fully vest and become immediately exercisable. In addition, if within 12 months of a change of control a holder of an option under the Company's amended and restated 1997 Stock Plan is terminated involuntarily other than for cause, the vesting schedule for such holder's option will accelerate with respect to an amount of shares equal to the number of shares that would otherwise vest over the following 12 months.

In the event that Mr. Dillon's employment is terminated by the Company other than for cause, Mr. Dillon will be entitled to severance of three months continued salary and benefits.

In the event that Ms. Kilgore's employment is terminated by the Company other than for cause, Ms. Kilgore will be entitled to severance of three months continued salary and benefits.

Code of Ethics

The Company has adopted a Code of Ethics for its directors, officers and other employees. A copy of the Code of Ethics is available on the Company's Web site at <http://ir.netflix.com>.

Section 16(a) Beneficial Ownership Compliance

Section 16(a) of the Securities Exchange Act of 1934 requires the Company's directors and executive officers, and persons who own more than 10% of a registered class of the Company's equity securities, to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of the Company's common stock and other equity securities of the Company. Officers, directors and greater than 10% stockholders are required by the Securities and Exchange Commission regulation to furnish the Company with copies of all Forms 3, 4 and 5 they file.

To the Company's knowledge, based solely on a review of the copies of such reports furnished to the Company and written representations that no other reports were required, during 2004, all of the Section 16(a) filing requirements applicable to the Company's officers, directors and greater than 10% stockholders were followed in 2004 except:

- reports on Form 4 relating to stock option grants received in February 2004 by the following officers were filed late: Thomas R. Dillon, Reed Hastings, Leslie J. Kilgore, and Barry McCarthy; and
- a report on Form 4 relating to the sale by Mr. Dillon of shares under a 10b5-1 trading plan in October 2004 was filed late.

REPORT OF THE COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

The Compensation Committee of the Board includes two non-employee directors. The Compensation Committee reviews and recommends to the Board compensation for the Company's executive officers.

Compensation Philosophy. The Company's executive pay programs are designed to attract and retain key executive talent that maximize stockholder value over time. The Company strongly believes that executive officers should have sufficient equity or equity-linked compensation so as to align the interests of executive officers with those of the Company's stockholders.

Components of Executive Compensation. The two key components of the Company's executive compensation program in 2004 were base salary and stock options. The Company considers the value of both base salary and stock options in determining total compensation for executive officers. In determining executive compensation, the Company considers a number of factors, including overall company performance, individual performance and comparative compensation data.

The Company utilizes a monthly option grant program as part of the compensation package for all executive officers. Under the option grant program, executive officers receive, on a monthly basis, fully vested options granted at fair market value. The Company's executive officers receive a significant portion of overall compensation in the form of these stock options. The Company believes that such monthly option granting aligns executive compensation with the Company's long-term business strategies and links such compensation with stockholder return.

In addition to the stock option program, executives are eligible to participate in the Company's 2002 Employee Stock Purchase Plan. Other elements of executive compensation include participation in company-wide medical and dental benefits and the ability to defer compensation pursuant to a 401(k) plan. The Company did not award any performance bonuses to executive officers in 2004.

Chief Executive Officer Compensation. The Compensation Committee used the philosophy and components described above in setting the annual compensation for the CEO, Reed Hastings. In considering Mr. Hastings' salary, the Compensation Committee not only considered these items, but also took into consideration his existing ownership of the Company's common stock, his accomplishments in developing the business strategy for the Company, and his ability to attract and retain senior management.

Section 162(m) of the Internal Revenue Code. The Compensation Committee has considered the potential impact of Section 162(m) (the Section) of the Internal Revenue Code adopted under the Federal Revenue Reconciliation Act of 1993. The Section disallows a tax deduction for any publicly held corporation for individual compensation exceeding \$1 million in any taxable year for any of the executive officers, other than compensation that is performance-based. The Compensation Committee concluded that the Section should not reduce the tax deductions available to the Company and that no changes to the Company's compensation program were needed in this regard. However, the Compensation Committee may from time to time approve compensation that is not deductible under this Section.

Ongoing Review. The Compensation Committee will be evaluating the Company's compensation policies on an ongoing basis to determine whether they are appropriate to attract, retain and motivate key personnel. The Compensation Committee may determine accordingly that it is appropriate to increase salaries, award additional stock options or grants of restricted stock, adjust the methods of granting long-term incentives or provide other short-term or long-term compensation to the executive officers.

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Compensation Committee of the Board of Directors

Timothy Haley

Jay Hoag

REPORT OF THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS

The Audit Committee engages and supervises the Company's independent registered public accounting firm and oversees the Company's financial reporting process on behalf of the Board. Management has the primary responsibility for the preparation of financial statements and the reporting process, including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited financial statements in the Company's annual report on Form 10-K for the year ended December 31, 2004 with management, including a discussion of the quality of the accounting principles, the reasonableness of significant judgments made by management and the clarity of disclosures in the financial statements.

The Audit Committee reviewed with KPMG LLP, the Company's independent registered public accounting firm, who are responsible for expressing an opinion on the conformity of the Company's audited financial statement with accounting principles generally accepted in the United States of America, their judgments as to the quality of the Company's accounting principles and the other matters required to be discussed with the Audit Committee under the auditing standards generally accepted in the United States of America, including the matters required by the Codification of Statements on Auditing Standards No. 61. In addition, the Audit Committee has discussed with KPMG LLP their independence from management and the Company, including the written disclosure and the letter regarding its independence as required by Independence Standards Board Standard No. 1, *Independence Discussions with the Audit Committees*.

The Audit Committee also reviewed the fees paid to KPMG LLP during the year ended December 31, 2004 for audit and non-audit services, which fees are described under the heading "Proposal Two: Ratification of Independent Registered Public Accounting Firm" above. The Audit Committee has determined that the rendering of any non-audit services by KPMG LLP was compatible with maintaining their independence.

The Audit Committee discussed with KPMG LLP the overall scope and plans for their audit. The Audit Committee meets with KPMG LLP, with and without management present, to discuss the results of their examinations, their evaluations or the Company's internal controls, and the overall quality of the Company's financial reporting.

Based on the reviews and discussions referred to above, the Audit Committee recommended to the Board that the audited financial statements be included in the annual report on Form 10-K for the year ended December 31, 2004, for filing with the Securities and Exchange Commission. The Audit Committee and the Board have also recommended, subject to stockholder ratification, the selection of KPMG LLP to audit the Company's financial statements for the year ending December 31, 2005.

Audit Committee of the Board of Directors

Timothy Haley

A. Robert Pisano

Michael Schuh

CERTAIN TRANSACTIONS

The Company has entered into indemnification agreements with each of its directors and executive officers. These agreements require the Company to indemnify such individuals, to the fullest extent permitted by Delaware law, for certain liabilities to which they may become subject as a result of their affiliation with the Company.

COMPARISON OF TOTAL CUMULATIVE STOCKHOLDER RETURN

The following graph compares the total cumulative stockholder return on the Company's common stock with the total cumulative return of the Nasdaq Composite Index and the Philadelphia Thetstreet.com Internet Sector Index for the period beginning on May 23, 2002, the date of the Company's initial public offering, through December 31, 2004. Total cumulative stockholder return assumes \$100 invested at the beginning of the period in the Company's common stock, the stocks represented in the Nasdaq Composite Index and the stocks represented in the Philadelphia Thetstreet.com Internet Sector Index, respectively. The Philadelphia Thetstreet.com Internet Sector Index is an equal-dollar-weighted index composed of 23 leading companies involved in Internet commerce, service and software. Historical stock price performance should not be relied upon as an indication of future stock price performance:

OTHER MATTERS

The Board knows of no other matters that will be presented for consideration at the Annual Meeting. If any other matters are properly brought before the Annual Meeting, the persons named in the accompanying proxy intend to vote on those matters in accordance with their best judgment.

By Order of the Board of Directors

/s/ Barry McCarthy

Barry McCarthy

Chief Financial Officer and Secretary

March 28, 2005

Los Gatos, California

FORM OF PROXY

NETFLIX, INC.

ANNUAL MEETING OF STOCKHOLDERS

MAY 11, 2005

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned stockholder of Netflix, Inc. (the Company) hereby acknowledges receipt of the Notice of Annual Meeting of Stockholders and Proxy Statement, each dated March 28, 2005, and hereby appoints Reed Hastings and Barry McCarthy, and each of them, with full power of substitution, as Proxy or Proxies to vote all shares of the Company's common stock of the undersigned at the Annual Meeting of Stockholders of Netflix, Inc. to be held on May 11, 2005, and at any adjournments thereof, upon the proposals set forth in this and described in the Proxy Statement, and in their discretion with respect to such other matters as may be properly brought before the meeting or any adjournments thereof.

If this proxy is properly executed and returned but no direction is made, this proxy will be voted for all of the nominees for Class III directors set forth below under item 1 and for ratification of the appointment of KPMG LLP as the Company's independent registered public accounting firm for the fiscal year ending December 31, 2005 (item 2).

Either of such Proxies or substitutes shall have and may exercise all of the powers of said Proxies hereunder.

1. To elect two Class III directors to hold office until the 2008 Annual Meeting of Stockholders:

(01) Jay Hoag; (02) Reed Hastings

.. FOR ALL NOMINEES

.. WITHHELD FROM ALL NOMINEES

..

For all nominees except as noted above

2. To ratify the appointment of KPMG LLP as the Company's independent registered public accounting firm for the year ending December 31, 2005.

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“ FOR

“ AGAINST

“ ABSTAIN

Mark box at right if an address change or comment has been noted on this card “

This Proxy should be marked, dated and signed by the stockholder or stockholders exactly as the stockholder s or stockholders names appear hereon, and returned promptly in the enclosed envelope. Persons signing in a fiduciary or representative capacity should so indicate. If shares are held by joint tenants, as community property or otherwise by more than one person, all should sign.

Signature: _____ Date: _____ Signature: _____ Date: _____