

CLST HOLDINGS, INC.  
Form 10-Q/A  
October 15, 2010  
[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q/A**

Amendment No. 1

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

For the quarterly period ended August 31, 2010

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 0-22972

## CLST HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**75-2479727**

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

**17304 Preston Road, Dominion Plaza, Suite 420**

**Dallas, Texas**

(Address of principal executive offices)

**75252**

(Zip Code)

**(972) 267-0500**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

On October 5, 2010, there were 23,949,282 outstanding shares of common stock, \$0.01 par value per share.

Table of Contents

**EXPLANATORY NOTE**

We are filing this Amendment No. 1 on Form 10-Q/A ( *Form 10-Q/A* ) to our Quarterly Report on Form 10-Q for the quarterly period ended August 31, 2010 originally filed with the SEC on October 6, 2010 (the *Original Form 10-Q* ) to update and clarify certain items regarding the market for the Company's common stock. For convenience, we have repeated the Original Form 10-Q in its entirety.

This amendment does not reflect events occurring after the filing of the Original Form 10-Q, and does not modify or update the disclosures therein in any way other than as required to reflect the matters described above.

**CLST HOLDINGS, INC.**

**INDEX TO FORM 10-Q/A**

|  | <b>Page</b> |
|--|-------------|
| <u>PART I FINANCIAL INFORMATION</u>  |             |
| <u>Item 1.</u>   |             |
| <u>FINANCIAL STATEMENTS</u>  | 3           |
| <u>CONSOLIDATED BALANCE SHEETS as of August 31, 2010 (unaudited) and November 30, 2009</u>   | 3           |
| <u>CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited) for the three and nine months ended August 31, 2010 and 2009</u>                                  | 4           |
| <u>CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS (unaudited) for the nine months ended August 31, 2010 and 2009</u> | 5           |
| <u>CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited) for the nine months ended August 31, 2010 and 2009</u>  | 6           |
| <u>NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)</u>  | 7           |
| <u>Item 2.</u>   |             |
| <u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>   | 18          |
| <u>Item 3.</u>   |             |
| <u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>  | 32          |
| <u>Item 4.</u>   |             |
| <u>CONTROLS AND PROCEDURES</u>   | 32          |
| <u>PART II OTHER INFORMATION</u>   |             |
| <u>Item 1.</u>   |             |
| <u>LEGAL PROCEEDINGS</u>   | 32          |
| <u>Item 1A.</u>  |             |
| <u>RISK FACTORS</u>  | 39          |
| <u>Item 2.</u>   |             |
| <u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>   | 39          |
| <u>Item 3.</u>   |             |
| <u>DEFAULTS UPON SENIOR SECURITIES</u>   | 39          |
| <u>Item 4.</u>   |             |
| <u>[REMOVED AND RESERVED]</u>  | 39          |
| <u>Item 5.</u>   |             |
| <u>OTHER INFORMATION</u>   | 39          |
| <u>Item 6.</u>   |             |
| <u>EXHIBITS</u>  | 40          |
| <u>SIGNATURES</u>  | 41          |



Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****CLST HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share data)

|  | August 31,<br>2010 | November 30,<br>2009 |
|--|--------------------|----------------------|
| <b>ASSETS</b>  |                    |                      |
| Current assets:  |                    |                      |
| Cash and cash equivalents  | \$ 2,430           | \$ 4,761             |
| Notes receivable, net - current  | 2,384              | 6,473                |
| Accounts receivable - other  | 308                | 2,741                |
| Prepaid expenses and other current assets  | 557                | 414                  |
| Total current assets   | 5,679              | 14,389               |
| Notes receivable, net - long-term  | 28,543             | 32,459               |
| Property and equipment, net  | 5                  | 7                    |
| Deferred income taxes  | 4,786              | 4,786                |
| Other assets   | 549                | 721                  |
|  | \$ 39,562          | \$ 52,362            |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)</b>   |                    |                      |
| Current liabilities:   |                    |                      |
| Accounts payable   | \$ 14,305          | \$ 14,705            |
| Accrued expenses   | 404                | 377                  |
| Income taxes payable   | 90                 | 99                   |
| Loans payable - current  | 25,990             | 33,663               |
| Notes payable - related parties - current  | 107                | 107                  |
| Total current liabilities  | 40,789             | 48,951               |
| Notes payable - related parties  |                    | 391                  |
| Total liabilities  | 40,789             | 49,342               |
| Commitments and contingencies  |                    |                      |
| Stockholders' equity (deficit):  |                    |                      |
| Preferred stock, \$.01 par value, 5,000,000 shares authorized; none issued   |                    |                      |
| Common stock, \$.01 par value, 200,000,000 shares authorized; 24,583,306 shares issued and 23,949,282 shares outstanding | 246                | 246                  |
| Additional paid-in capital   | 127,060            | 127,014              |
| Accumulated other comprehensive income-foreign currency translation adjustments  | 177                | 217                  |

Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

|   |           |           |
|---|-----------|-----------|
| Accumulated deficit                           | (127,063) | (122,810) |
|   | 420       | 4,667     |
| Less: Treasury stock (634,024 shares at cost) | (1,647)   | (1,647)   |
|   | (1,227)   | 3,020     |
|   | \$ 39,562 | \$ 52,362 |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**CLST HOLDINGS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF OPERATIONS

Three and nine months ended August 31, 2010 and 2009

(unaudited)

(In thousands, except per share data)

|   | Three months ended<br>August 31, |            | Nine months ended<br>August 31, |            |
|---|----------------------------------|------------|---------------------------------|------------|
|   | 2010                             | 2009       | 2010                            | 2009       |
| <b>Revenues:</b>                          |                                  |            |                                 |            |
| Interest income                           | \$ 1,244                         | \$ 1,655   | \$ 3,856                        | \$ 4,830   |
| Other                                     | 69                               | 102        | 195                             | 335        |
| Total revenues                            | 1,313                            | 1,757      | 4,051                           | 5,165      |
| Loan servicing fees                       | 301                              | 235        | 881                             | 621        |
| Provision for doubtful accounts           | 829                              | 654        | 2,580                           | 1,957      |
| Interest expense                          | 523                              | 508        | 1,634                           | 1,590      |
| General and administrative expenses       | 307                              | 1,517      | 3,219                           | 3,780      |
| Operating loss                            | (647)                            | (1,157)    | (4,263)                         | (2,783)    |
| <b>Other income:</b>                      |                                  |            |                                 |            |
| Other, net                                | 1                                | 1          | 44                              | 10         |
| Total other income                        | 1                                | 1          | 44                              | 10         |
| Loss before income taxes                  | (646)                            | (1,156)    | (4,219)                         | (2,773)    |
| Income tax expense (benefit)              | 20                               | 9          | 34                              | 17         |
| Net loss                                  | \$ (666)                         | \$ (1,165) | \$ (4,253)                      | \$ (2,790) |
| <b>Net loss per share:</b>                |                                  |            |                                 |            |
| <b>Basic and diluted:</b>                 |                                  |            |                                 |            |
| Net loss per share                        | \$ (0.03)                        | \$ (0.05)  | \$ (0.18)                       | \$ (0.12)  |
| <b>Weighted average number of shares:</b> |                                  |            |                                 |            |
| Basic and diluted                         | 23,649                           | 23,349     | 23,614                          | 22,662     |

See accompanying notes to unaudited consolidated financial statements.





Table of Contents**CLST HOLDINGS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY (DEFICIT) AND COMPREHENSIVE INCOME

Nine months ended August 31, 2010 and 2009

(Unaudited)

(In thousands)

|  | Common Stock |        | Treasury Stock |            | Additional      | Accumulated                       | Accumulated  | Total      |
|--|--------------|--------|----------------|------------|-----------------|-----------------------------------|--------------|------------|
|  | Shares       | Amount | Shares         | Amount     | paid-in capital | other comprehensive income (loss) | deficit      |            |
| Balance at November 30, 2009                     | 24,583       | \$ 246 | (634)          | \$ (1,647) | \$ 127,014      | \$ 217                            | \$ (122,810) | \$ 3,020   |
| Comprehensive loss:                              |              |        |                |            |                 |                                   |              |            |
| Net loss   |              |        |                |            |                 |                                   | (4,253)      | (4,253)    |
| Realized foreign currency translation adjustment |              |        |                |            |                 | (40)                              |              | (40)       |
| Total comprehensive loss                         |              |        |                |            |                 |                                   |              | (4,293)    |
| Amortization of restricted stock                 |              |        |                |            | 46              |                                   |              | 46         |
| Balance at August 31, 2010                       | 24,583       | \$ 246 | (634)          | \$ (1,647) | \$ 127,060      | \$ 177                            | \$ (127,063) | \$ (1,227) |
| Balance at November 30, 2008                     | 21,187       | \$ 212 | (634)          | \$ (1,647) | \$ 126,034      | \$ 217                            | \$ (117,616) | \$ 7,200   |
| Comprehensive loss:                              |              |        |                |            |                 |                                   |              |            |
| Net loss   |              |        |                |            |                 |                                   | (2,790)      | (2,790)    |
| Total comprehensive loss                         |              |        |                |            |                 |                                   |              | (2,790)    |
| Grant of restricted stock                        | 1,200        | 12     |                |            | (12)            |                                   |              |            |
| Cancellation of restricted stock                 | (300)        | (3)    |                |            | 3               |                                   |              |            |
| Amortization of restricted stock                 |              |        |                |            | 100             |                                   |              | 100        |
| Stock issuance for notes receivable              | 2,496        | 25     |                |            | 874             |                                   |              | 899        |
| Balance at August 31, 2009                       | 24,583       | \$ 246 | (634)          | \$ (1,647) | \$ 126,999      | \$ 217                            | \$ (120,406) | \$ 5,409   |

See accompanying notes to unaudited consolidated financial statements.



Table of Contents

**CLST HOLDINGS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

Nine months ended August 31, 2010 and 2009

(Unaudited)

(In thousands)

|   | 2010       | 2009       |
|---|------------|------------|
| Cash flows from operating activities:   |            |            |
| Net loss  | \$ (4,253) | \$ (2,790) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |            |            |
| Stock based compensation  | 46         | 100        |
| Provision for doubtful accounts   | 2,580      | 1,957      |
| Depreciation  | 3          | 4          |
| Non-cash interest expense   | 47         | 81         |
| Amortization of notes receivable acquisition costs  | 58         | 81         |
| Cumulative translation adjustment   | (40)       |            |
| Changes in operating assets and liabilities:  |            |            |
| Accounts receivable - other   | 2,296      | (258)      |
| Prepaid expenses and other current assets   | (143)      | 9          |
| Other assets  | 125        | (185)      |
| Accounts payable  | (400)      | (158)      |
| Income taxes payable  | (9)        | (125)      |
| Accrued expenses  | 27         | 94         |
| Net cash provided by (used in) operating activities                                       | 337        | (1,190)    |
| Cash flows from investing activities:   |            |            |
| Purchases of property and equipment   | (1)        |            |
| Notes receivable principal collections  | 4,994      | 8,137      |
| Acquisition of notes receivable   |            | (4,028)    |
| Additions to notes receivable acquisition costs   |            | (155)      |
| Net cash provided by investing activities   | 4,993      | 3,954      |
| Cash flows from financing activities:   |            |            |
| Payments on notes payable   | (7,661)    | (6,848)    |
| Net cash used in financing activities   | (7,661)    | (6,848)    |
| Net decrease in cash and cash equivalents   | (2,331)    | (4,084)    |
| Cash and cash equivalents at beginning of period  | 4,761      | 9,754      |

Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

|   |    |       |    |       |
|---|----|-------|----|-------|
| Cash and cash equivalents at end of period                        | \$ | 2,430 | \$ | 5,670 |
| Non-Cash Investing and Financing Activities:                      |    |       |    |       |
| Acquisition of notes receivable for common stock                  | \$ |       | \$ | 899   |
| Acquisition of notes receivable for debt                          | \$ |       | \$ | 7,273 |
| Acquisition of notes receivable for accounts receivable, other    | \$ |       | \$ | 336   |
| Returned notes receivable in exchange for reduction of debt       | \$ | 373   | \$ | 170   |
| Offset of debt against accounts receivable other - CLST Asset III | \$ | 137   | \$ |       |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents

**CLST HOLDINGS, INC. AND SUBSIDIARIES**

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**(1) Summary of Significant Accounting Policies**

**(a) Basis for Presentation**

Although the interim consolidated financial statements of CLST Holdings, Inc., formerly CellStar Corporation, and its subsidiaries (the *Company*) are unaudited, Company management is of the opinion that all adjustments (consisting of only normal recurring adjustments) necessary for a fair presentation of the results have been reflected therein. Net income (loss) for any interim period is not necessarily indicative of results that may be expected for any other interim period or for the entire year.

In accordance with the Company's plan of dissolution that was previously approved by our stockholders, on March 26, 2010 the Company filed a certificate of dissolution with the Delaware Secretary of State which became effective on June 24, 2010. Accordingly, immediately after the close of business on June 24, 2010, the Company closed its stock transfer books and discontinued recording transfers of shares of its common stock. Since June 24, 2010, there has only been limited trading activity among street name holders on the OTCQB of beneficial interests held by the Company's stockholders at the time of dissolution. The amount and timing of any distributions paid to stockholders in connection with the liquidation and dissolution of the Company are subject to uncertainties and depend on the resolution of certain contingencies. The Company's financial statements have been prepared on a going-concern basis and the asset and liability carrying amounts do not purport to present the net realizable or settlement values in the event of the dissolution and liquidation of the Company.

From November 2008 through February 2009, the Company consummated three acquisitions of consumer notes receivable portfolios. On November 10, 2008, the Company, through CLST Asset I, LLC (*CLST Asset I*), a wholly owned subsidiary of CLST Financo, Inc. (*Financo*), which is one of our direct, wholly owned subsidiaries, entered into a purchase agreement to acquire all of the outstanding equity interests of FCC Investment Trust I (*Trust I*) from a third party (the *Trust I Purchase Agreement*). The purchase price payable in the Trust I Purchase Agreement was financed pursuant to the terms and conditions set forth in the credit agreement, dated November 10, 2008, among Trust I, Fortress Credit Co LLC, as lender (*Fortress*), FCC Finance, LLC (*FCC*), as the initial servicer, the backup servicer, and the collateral custodian (the *Trust I Credit Agreement*). On December 12, 2008 we, through CLST Asset Trust II (*Trust II*), a newly formed trust wholly owned by CLST Asset II, LLC (*CLST Asset II*), a wholly owned subsidiary of Financo, entered into a purchase agreement (the *Trust II Purchase Agreement*) to acquire certain receivables, installment sales contracts and related assets owned by SSPE Investment Trust I (*SSPE Trust*) and SSPE, LLC (*SSPE*). Funding for Trust II included a non-recourse, revolving loan, which Trust II entered into with Summit Consumer Receivables Fund, L.P. (*Summit*), as originator, and SSPE and SSPE Trust, as co-borrowers, Summit and Eric J. Gangloff, as Guarantors, Fortress Credit Corp. (*Fortress Corp.*), as the lender, Summit Alternative Investments, LLC, as the initial servicer, and various other parties (*Trust II Credit Agreement*). On February 13, 2009, we, through CLST Asset III, LLC (*CLST Asset III*), a newly formed, wholly owned subsidiary of Financo, entered into a purchase agreement to acquire certain assets owned by Fair Finance Company, an Ohio corporation (*Fair*), James F. Cochran, Chairman and Director of Fair, and by Timothy S. Durham, Chief Executive Officer and Director of Fair and an officer, director and stockholder of our Company. Messrs. Durham and Cochran own all of the outstanding equity of Fair. For more information regarding each of these acquisitions please refer to Business 2009 Business in the Company's Annual Report on Form 10-K for the fiscal year

ended November 30, 2009.

The Company's consolidated financial statements include the Company's accounts and those of the majority-owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation. Unconsolidated subsidiaries and investments are accounted for under the equity method. Certain prior year financial amounts have been reclassified to conform to the current year presentation.

The report of our independent registered public accounting firm with respect to our financial statements as of November 30, 2009 and for the year then ended contains an explanatory paragraph with respect to our ability to continue as a going concern. This concern has been raised due to the higher than anticipated defaults on the notes receivable included in CLST Asset I which has resulted in a default under the Trust I Credit Agreement and an approximately \$3.5 million increase in the allowance for doubtful accounts during the twelve months ended November 30, 2009, with an additional \$2.6 million increase in the allowance for doubtful accounts through August 31, 2010. As a result of the Company's default under the Trust I Credit Agreement, the amount due to Fortress under this agreement has been classified as current as of November 30, 2009 and August 31, 2010. The Company has also been engaged in several lawsuits which have resulted in the Company incurring significant legal fees. The combination of the increase in the allowance for doubtful accounts and high legal fees resulted in the Company incurring a net loss of approximately \$5.2 million and \$4.3 million during the twelve months ended November 30, 2009 and the nine months ended August 31, 2010, respectively. The Company is continuing discussions to resolve the defaults under the Trust I Credit Agreement and the Trust II Credit Agreement. The Company has made a claim under its directors' and officers' liability insurance policy for reimbursement of legal fees incurred in excess of our \$1.0 million self retention amount. During the second quarter of 2010, the Company's directors' and officers' liability insurance carrier began to reimburse the Company for a portion of the legal fees incurred and began to pay certain attorneys' fees.

Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

Table of Contents

directly for services rendered. During the three months and nine months ended August 31, 2010, the Company received \$0.6 million and \$1.3 million, respectively, for the reimbursement of legal fees incurred and paid by the Company. These reimbursements, and any future reimbursements received, will offset the legal expenses incurred in general and administrative expenses. It is uncertain whether the Company can continue as a going concern or continue long enough to allow for an orderly sale of the Company's portfolios if it continues to incur net losses and if the Company loses the CLST Asset I and CLST Asset II consumer receivables as a result of the default under the Trust I Credit Agreement and the Trust II Credit Agreement.

**(b) Notes Receivable**

The following table shows certain information as of August 31, 2010 for each of CLST Asset I, CLST Asset II and CLST Asset III. A more detailed description of the results for each of these entities is provided in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations. Amounts presented are in thousands, except for the approximate number of customer accounts, the average outstanding principal balance per account, the weighted average remaining term (months) and the weighted average interest rate.

|  | CLST Asset I      |            | CLST Asset II     |            | CLST Asset III    |            |
|--|-------------------|------------|-------------------|------------|-------------------|------------|
|  | Principal Balance | % of Total | Principal Balance | % of Total | Principal Balance | % of Total |
| <b>Receivables Aging (Principal)</b>                     |                   |            |                   |            |                   |            |
| Current 0-30 Days  | \$ 23,450         | 76.3%      | \$ 5,937          | 93.5%      | \$ 778            | 83.2%      |
| 31 - 60 Days   | 885               | 2.9%       | 82                | 1.3%       | 61                | 6.5%       |
| 61 - 90 Days   | 692               | 2.3%       | 43                | 0.7%       | 58                | 6.2%       |
| 91 + 120   | 538               | 1.7%       | 49                | 0.8%       | 38                | 4.1%       |
| 120+   | 5,182             | 16.9%      | 240               | 3.7%       |                   | 0.0%       |
| Total Receivables  | 30,747            | 100.0%     | 6,351             | 100.0%     | 935               | 100.0%     |
| <b>Allowance for doubtful Accts</b>                      |                   |            |                   |            |                   |            |
|  | (5,971)           | -19.4%     | (293)             | -4.6%      | (38)              | -4.1%      |
| Net Receivables  | 24,776            | 80.6%      | 6,058             | 95.4%      | 897               | 95.9%      |
| Discount   | (427)             | -1.4%      | (525)             | -8.3%      | (28)              | -3.0%      |
| Acquisition fees   | 134               | 0.4%       | 21                | 0.3%       | 21                | 2.2%       |
| Total  | \$ 24,483         | 79.6%      | \$ 5,554          | 87.5%      | \$ 890            | 95.2%      |
| <b>Accounts Receivable Other</b>                         |                   |            |                   |            |                   |            |
|  | \$                |            | \$ 100            |            | \$ 13             |            |
| <b>Notes Payable and Loans Outstanding</b>               |                   |            |                   |            |                   |            |
|  | \$ 21,949         |            | \$ 4,041          |            | \$                |            |
| <b>Approximate Number of Customer Accounts</b>           |                   |            |                   |            |                   |            |
|  | 4,653             |            | 900               |            | 726               |            |
| <b>Average Outstanding Principal Balance per Account</b> |                   |            |                   |            |                   |            |
|  | \$ 6,608          |            | \$ 7,057          |            | \$ 1,288          |            |
| <b>Weighted Average Remaining Term, in Months</b>        |                   |            |                   |            |                   |            |
|  | 101               |            | 91                |            | 28                |            |

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

|                      |       |       |       |
|----------------------|-------|-------|-------|
| Weighted Average APR | 14.3% | 14.7% | 18.0% |
|----------------------|-------|-------|-------|

The majority of the notes receivable have collateral in various forms, which may include a second lien position on the borrower's home or property. Notes receivable are recorded at the historical cost paid at the date of acquisition net of any purchase discounts. Subsequent to the date of acquisition, notes receivable are reduced by any principal payments made by the customer. Purchase discounts are recorded based on the negotiated difference between the face value and the amount paid for the notes receivable. Purchase discounts are recognized as revenue, using the effective interest method, as principal payments are collected.

The Company establishes an allowance for doubtful accounts for receivables where the customer has not made a payment for the most recent 120 day period for CLST Asset I and the most recent 90 day period for CLST Asset II and CLST Asset III. The Company specifically analyzes notes receivable using historical activity, current economic trends, changes in its customer payment terms, recoveries of previously reserved notes and collection trends when evaluating the adequacy of its allowance for doubtful



Table of Contents

accounts. Any change in the assumptions used in analyzing a specific notes receivable may result in an additional allowance for doubtful accounts being recognized in the period in which the change occurs. During the fourth quarter of 2009, the Company modified its reserve policy due to recent market trends. Additional reserves are accrued based on account balances that are over 60 days past due with the reserve amount dependent on the overall performance of the portfolio. The Company may also establish an additional reserve for any portfolio that, in management's judgment, may need to be discounted at a future date in order to sell the portfolio in its entirety. Any reserve amount may be reduced based upon any offset rights or claims the Company may have against parties who initially sold the portfolio to the Company. The Company may from time to time make additional increases to the allowance based on the foregoing factors. Once a note receivable has been reserved due to nonpayment, the Company will no longer accrue, for financial reporting purposes, interest earned on the notes receivable. Should the note receivable return to a performing status, then the Company will resume accruing interest on the note receivable. Recoveries are recorded against the allowance when payments are received. Notes receivable are charged off against the allowance after all means of collection have been exhausted and a legal determination has been rendered that less than the full amount of the notes receivable will be collected. Recoveries of notes receivable, which were previously charged off, are recorded to income when payments are received.

The following table details the activity in the allowance for doubtful accounts for the three and nine months ended August 31, 2010 and 2009, respectively (in thousands):

|   | For the three months ended<br>August 31, |          | For the nine months ended<br>August 31, |          |
|---|--|----------|---|----------|
|   | 2010                                     | 2009     | 2010                                    | 2009     |
| Beginning balance                           | \$ 5,466                                 | \$ 1,447 | \$ 3,668                                | \$ 144   |
| Additions to allow for doubtful<br>accounts | 829                                      | 654      | 2,580                                   | 1,957    |
| Other                                       | 7  |          | 54                                      |          |
| Charge offs                                 |  |          |   |          |
| Ending balance                              | \$ 6,302                                 | \$ 2,101 | \$ 6,302                                | \$ 2,101 |

Beginning in the third quarter of 2009 and continuing through the third quarter of 2010, the annualized default rate for CLST Asset I increased, reaching as high as 15.8% in April 2010; accordingly, we have been increasing our allowances to reflect this change. The Company is in default of the Trust I Credit Agreement as a result of higher than anticipated notes receivable defaults. As a result of the default, the entire balance of \$21.9 million due to Fortress under the Trust I Credit Agreement has been classified as current on the August 31, 2010 balance sheet. Had the Company not been in default under the Trust I Credit Agreement, \$17.0 million of the outstanding balance as of August 31, 2010 would have been classified as non-current. In May 2010, the Company received a notice of default from Fortress Corp. stating that an event of default had occurred and was continuing under the Trust II Credit Agreement as a result of the three-month rolling average Class A default ratio of the receivables exceeding 5.0%. The Company is currently in discussions with its lenders to resolve any defaults under the Trust I Credit Agreement and the Trust II Credit Agreement. Those discussions are ongoing and the Company does not expect that its lenders will enforce any available foreclosure rights they may have on the assets of Trust I and Trust II while negotiations are proceeding. The Company has engaged Raymond James & Associates, Inc. to assist the Company in these lender negotiations and to seek replacement financing for borrowings under the Trust II Credit Agreement which matured on September 28, 2010 and has not been repaid. CLST Asset III had a \$38,000 provision for doubtful accounts as of August 31, 2010 which represents the allowance for doubtful accounts in excess of the amounts that have been offset against the notes payable to the sellers per the Trust III Purchase Agreement. Defaults of \$373,000 during the nine months ended August 31, 2010 were applied to the notes payable to the sellers and during the three months ended August 31, 2010, the notes payable to the sellers were completely offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted. However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be.

**(c) Revenue Recognition**

Revenues, which consist of interest earned, late fees and other miscellaneous charges, are recorded as earned from notes receivable. Revenues are not accrued on accounts without payment activity for over 120 days and 90 days for CLST Asset I and CLST Asset II, respectively, unless payment activity resumes.

Table of Contents

**(d) Deferred Costs**

We have recorded acquisition costs related to the purchase of certain notes receivable and deferred loan costs associated with certain Company obligations. The acquisition costs are amortized over the remaining principal balance of the notes receivable and are recorded as contra revenue. The deferred loan costs are amortized over the remaining outstanding balance of the Company obligation and are recorded in operating interest expense. Any impact of prepayment of the balances by either the Company or our customers would be recognized in the period of prepayment.

**(2) Stock-Based Compensation**

For the three and nine months ended August 31, 2010, the Company recognized \$15,000 and \$46,000 of expense, respectively, related to restricted stock grants.

**(3) Net Loss Per Share**

Options to purchase 0.1 million shares of Common Stock were not included in the computation of diluted earnings per share for the three and nine months ended August 31, 2010 and 2009 because the exercise price was higher than the average market price. 0.3 million shares of the Company's restricted stock for the three and nine months ended August 31, 2010, and 0.6 million shares of the Company's restricted stock for the three and nine months ended August 31, 2009, were not included in the computation of diluted earnings per share because their inclusion would have been anti-dilutive as the Company had a net loss.

**(4) Fair Value Measurements**

In April 2009, the Financial Accounting Standards Board issued Accounting Standards Codification (ASC) 825 (formerly FSP FAS 107-1), *Interim Disclosures about Fair Value of Financial Instruments*. ASC 825 requires disclosures about the fair value of financial instruments whenever a public company issues financial information for interim reporting periods. ASC 825 is effective for interim reporting periods ending after June 15, 2009. The Company adopted this staff position upon its issuance, and it had no material impact on its consolidated financial statements.

The carrying amounts of accounts receivable, accounts payable and accrued liabilities as of August 31, 2010 and 2009 approximate fair value due to the short maturity of these instruments. The carrying value of notes receivable, loans payable and notes payable-related parties also approximate fair value since these instruments bear market rates of interest, and notes receivable are net of allowances and purchase discounts.

**(5) Commitments and Contingencies**

## Introduction

The Company has expended a significant amount of management time and resources in connection with the Federal Court Action and the State Court Action (as defined below). The Company has had settlement discussions with Red Oak Fund, L.P. and certain of its affiliates ( **Red Oak** or the **Red Oak Group** ) from time to time in the past regarding the Federal Court Action, but those discussions have not been successful. The Company may have further settlement discussions with Red Oak in the future. No assurance can be given that any settlement agreement could be reached if the Company undertakes further discussions or, if a settlement agreement is entered into, that the terms of any settlement would not have a material adverse effect on the Company, its financial position, or its results of operations.

On June 18, 2010, the State Court Action was dismissed, as discussed below. However, on June 23, 2010 Ron Phillips and Scott Moorehead filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 298th District Court of Dallas County, Texas. No assurance can be given of the effect that the newly filed state court lawsuit will have on the Company, its financial position or its results of operations.

## Red Oak Federal Court Action

In December 2008, David Sandberg of the Red Oak Group placed a telephone call to Robert Kaiser expressing interest in the Red Oak Group making a minority investment in the Company and obtaining control of the Company. The Company's Board of Directors (the **Board** ) responded by suggesting that the Red Oak Group and the Company discuss the Red Oak Group's desire to make a minority investment and obtain control after the Company filed its Annual Report on Form 10-K for the fiscal year ended November 30, 2008 with the SEC and made its results of operations available to the Company's stockholders.

Table of Contents

On January 15, 2009, the Red Oak Group acquired 5,000 shares of our common stock in secondary market and privately negotiated transactions. On or about January 30, 2009, the Red Oak Group requested that the Company provide a stockholder list and security position listings, which it said it would use to make a tender offer. On February 3, 2009, the Red Oak Group announced its plan to commence a tender offer to acquire up to 70% of our outstanding shares of common stock at \$0.25 per share. On February 5, 2009, we adopted the Rights Agreement, by and between the Company and Mellon Investor Services LLC, as Rights Agent (the **Rights Plan**) which became effective on February 16, 2009. Stating the Company's Rights Plan as its reason, the Red Oak Group announced on February 9, 2009 that it had abandoned its intention to make a tender offer. Nevertheless, the Red Oak Group continued through February 13, 2009 to acquire shares of our common stock in the secondary market and privately negotiated transactions resulting in its beneficial ownership of 4,561,554 shares of our common stock (according to the Red Oak Group's Schedule 13D filed with the SEC on February 18, 2009), representing approximately 19.05% of our outstanding common stock as of the record date. The Red Oak Group made its purchases of our common stock in open-market and privately negotiated transactions, not by means of tender offer materials filed with the SEC.

On February 13, 2009, we filed a lawsuit in the United States District Court for the Northern District of Texas against Red Oak Fund, L.P., Red Oak Partners, LLC, and David Sandberg (the **Federal Court Action**). Our Original Complaint and Application for Injunctive Relief alleges that Red Oak engaged in numerous violations of federal securities laws in making purchases of our common stock and sought to enjoin any future unlawful purchases of our stock by them, their agents, and persons or entities acting in concert with them. We believe Red Oak violated federal securities laws as follows:

- (i) violating Rule 14(e)-5 of the Exchange Act by not truly abandoning its tender offer and instead directly or indirectly purchasing or arranging to purchase shares not in connection with its tender offer and without complying with the procedural, disclosure and anti-fraud requirements applicable to tender offers regulated under Section 14 of the Exchange Act;
- (ii) violating Exchange Act Rule 14d-5(f) by failing to return the Company's stockholder list, which we provided to Red Oak upon its request, and by using such list for a purpose other than in connection with the dissemination of tender offer materials in connection with its tender offer;
- (iii) violating Exchange Act Rule 14(d)-10 by purchasing shares pursuant to its tender offer at varying prices rather than paying consideration for securities tendered in the tender offer at the highest consideration paid to any stockholder for securities tendered; and
- (iv) violating Section 13(d) of the Exchange Act by not timely filing a Schedule 13D and disclosing the information required therein.

On March 13, 2009, we announced that we would hold our Annual Meeting of Stockholders on May 22, 2009 in Dallas, Texas, and that the close of business on April 2, 2009 would be the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting or any adjournments or postponements thereof.

On March 18, 2009, the Red Oak Group sent a letter to us demanding to inspect and copy certain of our books and records. We have taken the position that the Red Oak Group did not comply with state law requirements applicable to stockholders seeking such information.

On March 19, 2009, the Red Oak Group sent a letter to us stating its intention to put forth several precatory proposals including stockholder votes for: approval to proceed with the 2007 stockholder-approved plan of dissolution; approval of the November 10, 2008 transaction whereby CLST Asset I, a wholly owned subsidiary of Financo, entered into a purchase agreement to acquire all of the outstanding equity interests of Trust I from a third party for approximately \$41.0 million; approval of the 2008 Plan pursuant to which the Board approved the new issuance to themselves of up to 20 million shares of common stock, or just over 97% of the common stock outstanding at the time this plan was approved; approval of the December 12, 2008 transaction whereby Trust II, a newly formed trust wholly owned by CLST Asset II, a wholly owned subsidiary of Financo entered into a purchase agreement, effective as of December 10, 2008, to acquire (i) on or before February 28, 2009 receivables of at least \$2 million, subject to certain limitations and (ii) from time to time certain other receivables, installment sales contracts, and related assets; and approval of the February 13, 2009 transaction whereby CLST Asset III, a newly formed, wholly owned subsidiary of Financo, which is one of CLST's direct, wholly owned subsidiaries, purchased certain receivables, installment sales contracts, and related assets owned by Fair, which is partly owned by Timothy S. Durham, an officer and director of CLST. On the same day, the Red Oak Group sent a letter to us stating its intention to nominate a slate of directors to our Board.

On April 6, 2009, we notified the Red Oak Group that our Board rejected the Red Oak Group's nominations for Class I and Class II seats, as the nominations were not in accordance with our certificate of incorporation. In addition, we also rejected the Red

Table of Contents

Oak Group's proposals because they were not proper in form or substance under federal and state law to come before an Annual Meeting. We offered to discuss the Red Oak Group's concerns, director nominations, and stockholder proposals provided that (1) the Red Oak Group and the Company enter into a confidentiality and standstill agreement, (2) the Red Oak Group appropriately make publicly available disclosures regarding its rapid accumulation of the Company's shares and its intentions to acquire control of the Company that are required by the federal securities laws, including in a Report on Schedule 13D, and (3) the Red Oak Group not vote the shares that the Company believes it to have acquired in violation of applicable law, including the tender offer rules and other rules regulating such accumulation of shares under the federal securities laws, at the Annual Meeting.

Also on April 6, 2009, we filed our First Amended Complaint and Application for Injunctive Relief in the Federal Court Action adding Red Oak's affiliates (Pinnacle Partners, LLC; Pinnacle Fund, LLLP; and Bear Market Opportunity Fund, L.P.) as defendants, alleging the same and other violations of federal securities laws, including:

- (i) filing a materially false and misleading Schedule 13D and failing to amend the same after delivering to the Company a Notice of Director Nominations and proposal for business at the Annual Meeting;
- (ii) violating Section 14(d) of the Exchange Act by engaging in fraudulent, deceptive and manipulative acts in connection with its tender offer by failing to abide by Section 14(d)'s timing requirements and by failing to make required filings with the SEC; and
- (iii) that any attempt to solicit proxies from our stockholders with respect to director nominations or notice of business would be misleading in light of the defendants' illegal activities in accumulating Company stock.

Through this action, we seek to obtain various declaratory judgments that the defendants have failed to comply with federal securities laws and to enjoin the defendants from, among other things, further violating federal securities laws and from voting any and all shares or proxies acquired in violation of such laws.

Also on April 6, 2009, because, among other reasons, we did not expect the litigation, which bears directly upon our Annual Meeting of stockholders, to be resolved for some months, our Board postponed the Annual Meeting of stockholders previously scheduled for May 22, 2009 until September 25, 2009.

On April 15, 2009, the Red Oak Group submitted another letter to the Company, providing additional information regarding the stockholder proposals it intends to bring before the Annual Meeting and revising those proposals to: request the Board to complete the dissolution approved at the stockholder meeting held in 2007; advise the Board that the stockholders do not approve of the transaction purportedly entered into as of November 10, 2008 whereby CLST Asset I, a wholly owned indirect subsidiary of the Company, entered into a purchase agreement to acquire the outstanding equity interest in Trust I and request the directors to take any available and appropriate actions; disapprove the 2008 Plan adopted by the Board and request the Board not to issue any additional share grants or option grants under such plan and request that the directors rescind their approval of such plan; advise the Board that the stockholders disapprove of the transaction purportedly entered into as of December 12, 2008 pursuant to which CLST Asset II, an indirect wholly owned subsidiary of the Company, entered into a purchase agreement to acquire certain receivables on or before February 28, 2009 and request the directors to take any available and appropriate actions; and advise the Board that the stockholders disapprove of the transaction purportedly entered into as of February 13, 2009 whereby CLST Asset III, an

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

indirect wholly owned subsidiary of the Company purchased certain receivables, installment contracts and related assets owned by Fair and request the directors to take any available and appropriate actions.

On July 24, 2009, we filed our Brief in Support of Application for Preliminary Injunction. The Red Oak Group filed its Opposition on August 7, 2009, and we filed our Reply Brief in Support on August 14, 2009. On October 14, 2009, the court denied the Company's Application for Preliminary Injunction.

On December 30, 2009, the Company voluntarily filed a Motion to Dismiss the Federal Court Action ( *Federal Motion to Dismiss* ). As an exercise of its business judgment, the Board decided not to pursue CLST's claims against the Red Oak Group beyond the preliminary injunction stage.

On January 20, 2010, the Red Oak Group filed its Combined Motion for Leave to Amend, to Join Third Parties, to Vacate Scheduling Order and to Continue the Trial Date ( *Motion for Leave* ) and its Motion for Attorneys' Fees under Rule 11 of the Federal Rules of Civil Procedure ( *Rule 11 Motion* ). By its Motion for Leave, Red Oak sought to join Messrs. Durham, Kaiser, and Tornek as defendants and to add claims against them and CLST respectively for alleged violations of Sections 13(d), 14(a), and 10(b) of the Exchange Act and certain rules promulgated thereunder. By its Rule 11 Motion, the Red Oak Group sought to recover all of its attorneys' fees and costs in defending this action from CLST based on the legal contention that injunctive relief is not available for a violation of Section 13(d) of the Exchange Act.



Table of Contents

On March 2, 2010, the court denied the Federal Motion to Dismiss and granted the Red Oak Group's Motion for Leave. The court also denied the Red Oak Group's Rule 11 Motion. On March 17, 2010, the Red Oak Group filed its Counterclaims and Third-Party Complaint against the Company, alleging violations of Sections 13(d), 14(a) and 10(b) of the Exchange Act.

On April 21, 2010, Red Oak filed its Motion to Expedite Discovery and Briefing Schedule ( *Motion for Expedited Discovery* ). The same day, Red Oak filed its Application for a Preliminary Injunction to Issue Before June 6, 2010 ( *Application for Preliminary Injunction* ). Red Oak's Application for Preliminary Injunction sought a preliminary injunction compelling Messrs. Kaiser, Durham, and Tornek to make corrective disclosures to comply with alleged violations of Section 13(d) of the Exchange Act. Red Oak's Motion for Expedited Discovery sought discovery in support of its Application for Preliminary Injunction. On May 4, 2010, the court denied Red Oak's Motion for Expedited Discovery and further denied Red Oak's Application for Preliminary Injunction.

On May 17, 2010, the Company filed its Motion to Dismiss Red Oak's Counterclaims and Brief in Support ( *Motion to Dismiss Red Oak's Counterclaims* ) seeking to dismiss all alleged violations of Sections 13(d), 14(a), and 10(b) of the Exchange Act. The same day, Messrs. Kaiser, Durham, and Tornek individually filed respective motions to dismiss Red Oak's third-party claims. On June 21, 2010, Red Oak filed its consolidated Opposition to Motions to Dismiss. Therein, Red Oak states that its disclosure-based Section 13(d) and 14(a) claims are moot and that it intends to voluntarily dismiss those claims. On July 21, 2010, Red Oak filed a Notice of Dismissal, thereby dismissing its disclosure-based Section 13(d) and 14(a) claims. On August 20, 2010, the court denied CLST's Motion to Dismiss Red Oak's Counterclaims and the respective motions to dismiss filed by Messrs. Kaiser and Durham; the court, however, granted Mr. Tornek's motion to dismiss. The Federal Court Action remains pending.

**Red Oak State Court Action**

On March 2, 2009, certain members of the Red Oak Group (namely, Red Oak Partners, LLC; Pinnacle Fund, LLP; and Bear Market Opportunity Fund, L.P.) and Jeffrey S. Jones ( *Jones* ) (the Red Oak Group and Jones may be collectively referred to below as *Plaintiffs* ) filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 134th District Court of Dallas County, Texas (the *State Court Action* ). The petition alleges that Messrs. Kaiser, Durham, and Tornek entered into self-dealing transactions at the expense of the Company and its stockholders and violated their fiduciary duties of loyalty, independence, due care, good faith, and fair dealing. The petition asks the court to order, among other things, a rescission of the alleged self-interested transactions by Messrs. Kaiser, Durham, and Tornek; an award of compensatory and punitive damages; the removal of Messrs. Kaiser, Durham, and Tornek from the Board; and that the Company hold an Annual Meeting of stockholders, or that the Company appoint a conservator to oversee and implement the dissolution plan approved by stockholders in 2007.

On March 13, 2009, we announced that we would hold our Annual Meeting of Stockholders on May 22, 2009 in Dallas, Texas, and that the close of business on April 2, 2009 would be the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting or any adjournments or postponements thereof.

On March 18, 2009, the Red Oak Group sent a letter to us demanding to inspect and copy certain of our books and records. We took the position that the Red Oak Group did not comply with state law requirements applicable to stockholders seeking such information.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

On March 19, 2009, the Red Oak Group sent a letter to us stating its intention to put forth several precatory proposals including stockholder votes for: approval to proceed with the 2007 stockholder-approved plan of dissolution; approval of the November 10, 2008 transaction whereby CLST Asset I, a wholly owned subsidiary of Financo, entered into a purchase agreement to acquire all of the outstanding equity interests of Trust I from a third party for approximately \$41.0 million; approval of the 2008 Plan pursuant to which the Board approved the new issuance to themselves of up to 20 million shares of common stock, or just over 97% of the common stock outstanding at the time this plan was approved; approval of the December 12, 2008 transaction whereby Trust II, a newly formed trust wholly owned by CLST Asset II, a wholly owned subsidiary of Financo entered into a purchase agreement, effective as of December 10, 2008, to acquire (i) on or before February 28, 2009 receivables of at least \$2 million, subject to certain limitations and (ii) from time to time certain other receivables, installment sales contracts and related assets; and approval of the February 13, 2009 transaction whereby CLST Asset III, a newly formed, wholly owned subsidiary of Financo, which is one of CLST's direct, wholly owned subsidiaries, purchased certain receivables, installment sales contracts and related assets owned by Fair, which is partly owned by Timothy S. Durham, an officer and director of CLST. On the same day, the Red Oak Group sent a letter to us stating its intention to nominate a slate of directors to our Board.

On April 6, 2009, we notified the Red Oak Group that our Board rejected the Red Oak Group's nominations for Class I and Class II seats, as the nominations were not in accordance with our certificate of incorporation. In addition, we also rejected the Red

Table of Contents

Oak Group's proposals because they were not proper in form or substance under federal and state law to come before an Annual Meeting. We offered to discuss the Red Oak Group's concerns, director nominations, and stockholder proposals provided that (1) the Red Oak Group and the Company enter into a confidentiality and standstill agreement, (2) the Red Oak Group appropriately make publicly available disclosures regarding its rapid accumulation of the Company's shares and its intentions to acquire control of the Company that are required by the federal securities laws, including in a Report on Schedule 13D, and (3) the Red Oak Group not vote the shares that the Company believes it to have acquired in violation of applicable law, including the tender offer rules and other rules regulating such accumulation of shares under the federal securities laws, at the Annual Meeting.

Also on April 6, 2009, because, among other reasons, we did not expect the litigation, which bears directly upon our Annual Meeting of stockholders, to be resolved for some months, our Board postponed the Annual Meeting of stockholders previously scheduled for May 22, 2009 until September 25, 2009.

On April 15, 2009, the Red Oak Group submitted another letter to the Company, providing additional information regarding the stockholder proposals it intends to bring before the Annual Meeting and revising those proposals to: request the Board to complete the dissolution approved at the stockholder meeting held in 2007; advise the Board that the stockholders do not approve of the transaction purportedly entered into as of November 10, 2008 whereby CLST Asset I, a wholly owned indirect subsidiary of the Company, entered into a purchase agreement to acquire the outstanding equity interest in Trust I and request the directors to take any available and appropriate actions; disapprove the 2008 Plan adopted by the Board and request the Board not to issue any additional share grants or option grants under such plan and request that the directors rescind their approval of such plan; advise the Board that the stockholders disapprove of the transaction purportedly entered into as of December 12, 2008 pursuant to which CLST Asset II, an indirect wholly owned subsidiary of the Company, entered into a purchase agreement to acquire certain receivables on or before February 28, 2009 and request the directors to take any available and appropriate actions; and advise the Board that the stockholders disapprove of the transaction purportedly entered into as of February 13, 2009 whereby CLST Asset III, an indirect wholly owned subsidiary of the Company purchased certain receivables, installment contracts and related assets owned by Fair and request the directors to take any available and appropriate actions.

On April 30, 2009, the Red Oak Group and Jones amended their petition in the State Court Action. In addition to the relief already requested, the petition sought to compel the Company to hold its 2008 and 2009 annual stockholders' meetings within sixty days; to enjoin Messrs. Kaiser, Durham, and Tornek from any interference or hindrance of such meetings or the election of directors; to enjoin Messrs. Kaiser, Durham, and Tornek from voting any shares of stock acquired in the alleged self-interested transactions; and to appoint a special master. On June 3, 2009 and again on June 12, 2009, pursuant to court order, the Red Oak Group and Jones amended their petition to, among other things, remove Bear Market Opportunity Fund, L.P. as a plaintiff and add Red Oak Fund, L.P. as a plaintiff.

On May 5, 2009, the Red Oak Group and Jones filed a motion seeking to compel the Company to hold its 2008 and 2009 stockholders' meetings on June 30, 2009 and to appoint a special master and requested an expedited hearing on both. Hearings were held on May 8, 2009 and May 29, 2009, but no ruling was reached.

On August 14, 2009, our Board postponed the Annual Meeting of stockholders from September 25, 2009 to October 27, 2009.

On August 24, 2009, the Red Oak Group resubmitted its director nomination letter and its letter stating its intention to put forth the stockholder proposals, as mentioned in the March 19, 2009 and April 15, 2009 letters.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

On August 25, 2009, the court set an evidentiary hearing on the Plaintiffs' Application for Temporary Injunction, which had yet to be filed, for October 7 and 8, 2009. Plaintiffs' request for injunctive relief concerned Messrs. Kaiser, Durham, and Tornek voting any shares of stock acquired in the alleged self-interested transactions.

On August 28, 2009, the parties executed a Stipulation Regarding the Company's Annual Meeting of Stockholders ( *Stipulation* ). The court approved the Stipulation the same day and entered an Order identical to the Stipulation's terms. Pursuant to the Stipulation, absent a determination by the court of good cause shown, the Company must hold its annual stockholders' meeting for the election of one Class I director and one Class II director and consideration of any properly submitted proposals that are proper subjects for consideration at an annual meeting on October 27, 2009, with a record date for that meeting of September 25, 2009. Good cause for delaying the Annual Meeting beyond October 27, 2009, and correspondingly amending the September 25, 2009 record date, includes among other things, situations where reasonable delay is necessary: (1) for the Board to avoid breaching any of their fiduciary duties to the Company or the Company's stockholders; (2) to assure compliance with the Company's certificate of incorporation and bylaws; (3) for the Company or the Board to comply with state or federal law; or (4) to assure compliance with any order of any court or regulatory authority having jurisdiction over the Company or members of its Board.

Table of Contents

We received a letter dated September 22, 2009 from the Red Oak Group seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company, including among other things a stockholder list as of the record date. The letter states that the purpose of such request is to enable the Red Oak Group to solicit proxies to elect directors at the 2009 Annual Meeting and to communicate with stockholders. Our counsel responded by letter dated September 30, 2009 that the Company was aware of its obligations under Section 220 of the Delaware General Corporation Law but believed that the demand letter did not comply with the inspection requirements under Section 220. We received another letter dated September 29, 2009 from the Red Oak Group pursuant to Section 220 of the Delaware General Corporation Law in which the Red Oak Group requests to inspect the books and records of the Company pertaining to, among other things, all analyses performed with respect to our net operating losses and a list of all business ventures and dealings Messrs. Tornek and Durham have evaluated or commenced in the past ten years and a list of all investments they currently share. Our counsel responded by letter dated October 6, 2009 that (i) the commencement of the Red Oak Group's derivative action bars it from using a Section 220 demand as a substitute for discovery permissible in litigation; (ii) the stated purposes of the demand letter do not constitute proper purposes under Section 220; and (iii) the scope of information requested in the demand letter is overly broad and not limited to books and records that are essential and sufficient to accomplish the Red Oak Group's stated purposes.

On October 9, 2009, the court denied Plaintiffs' application for injunctive relief, which sought to enjoin Messrs. Kaiser, Durham, and Tornek from voting certain shares at the CLST annual stockholders' meeting. Further, the court granted Defendants' plea to the jurisdiction, granted Defendants' motion to disqualify Plaintiffs, and dismissed Plaintiffs' derivative claims. Beyond that, the court granted Defendants' amended motion to stay, thereby staying all remaining direct claims asserted by Plaintiffs. Defendants' motion to disqualify Plaintiffs was based on Plaintiffs' lack of adequacy to pursue derivative claims on the following grounds: (1) that Red Oak improperly brought derivative claims to advance its own personal interests; (2) that Red Oak had engaged in illegal conduct by violating federal securities laws; and (3) that Jones was only a tag-along plaintiff and therefore suffered the same adequacy problems as Red Oak, the driving force behind the State Court Action. The court reached each of these rulings after the two-day evidentiary hearing.

On October 15, 2009, we applied to the court, on an emergency basis, for an order to: (1) reopen this case for the limited purpose of modifying the court's Order Regarding Annual Meeting of Stockholders entered on August 28, 2009 (the **Annual Meeting Order**); (2) modify its Annual Meeting Order to prevent CLST from alternatively being in violation of (a) federal securities law, Delaware statutory law, and its Bylaws or (b) the Annual Meeting Order; (3) nullify the current September 25, 2009 record date; and (4) grant an emergency hearing as soon as possible. A hearing was held on CLST's emergency motion on October 16, 2009. The court continued the hearing until a time agreeable to the parties and the court on or before October 26, 2009.

On October 29, 2009, Plaintiffs filed their Motion and Memorandum to Reopen Case And To Reconsider ( **Motion to Reconsider** ) concerning the court's Order of October 9, 2009, which granted Defendants' Plea to the Jurisdiction and Motion to Disqualify Plaintiffs and dismissed Plaintiffs' derivative claims. On December 10, 2009, Plaintiffs filed their Motion and Memorandum to Reopen Case and Compel Annual Stockholders' Meeting ( **Motion to Compel** ).

On November 12, 2009, the parties executed a Second Stipulation and Order Setting and Regarding an Annual Meeting of Stockholders of the Company (the **Second Stipulation** ). The court approved the Second Stipulation on November 13, 2009 and entered an Order identical to the Second Stipulation's terms. The Second Stipulation provides that the Company must hold its annual stockholders' meeting on December 15, 2009 and that the record date for that meeting must be set as October 30, 2009.

At the December 15, 2009 hearing on Plaintiffs' Motion to Reconsider, Plaintiffs' counsel stated on the record that Plaintiffs' Motion to Compel had not been properly noticed and therefore was not before the court. The court denied Plaintiffs' Motion to Reconsider on December 21, 2009.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

On January 15, 2010, Plaintiffs filed their Motion for Summary Relief, Summary Judgment, and Application for Injunctive Relief to Compel the Company's Annual Stockholders Meeting ( *Motion for Summary Relief* ). By their Motion for Summary Relief, Plaintiffs sought for the Company to hold its annual stockholders meetings for 2008, 2009, and 2010 on March 25, 2010. On February 15, 2010, the court heard Plaintiffs Motion for Summary Relief and, in part, granted the relief requested. Specifically, the court ordered, pursuant to its Order and Interlocutory Partial Summary Judgment (the *Second Annual Meeting Order* ) as follows: (1) Absent a determination by the Court for good cause shown, the Company shall hold its annual stockholders meeting on March 23, 2010 (the *Annual Meeting* ); the Annual Meeting satisfies the Company's requirement to hold its 2008 and 2009 annual stockholders meetings; the record date for the Annual Meeting shall be March 8, 2010; and the Company shall provide notice in accordance with applicable Delaware law to all CLST stockholders on or before March 12, 2010 for the Annual Meeting. By the same order, the court also appointed IVS Associates, Inc. to be the independent inspector of elections to oversee the voting process of the Annual Meeting, tabulate proxies, and certify the election results. By separate order dated February 15, 2010, and upon its own motion, the court ordered that the State Court Action be reopened and reinstated on a two-week trial docket beginning June 1, 2010.

Table of Contents

On February 18, 2010, the Red Oak Group filed its Application for TRO and sought to prevent the Company from filing a certificate of dissolution with the Delaware Secretary of State on February 26, 2010, as the Company had disclosed in its Form 8-K filed on February 9, 2010. The hearing on the Application for TRO was held on February 23, 2010. On February 24, 2010, the court granted Red Oak's Application for TRO and, pursuant to the TRO, ordered, among other things, that the defendants (namely, CLST Holdings, Inc., Robert Kaiser, Timothy Durham, and David Tornek) and their agents be restrained from filing the certificate of dissolution for the Company on or before midnight on Wednesday, March 10, 2010, or until further order of the court.

On March 2, 2010, the court signed the order upon the Stipulation and Agreed Temporary Injunction with Red Oak (the *Dissolution Stipulation*), which provides, among other things, that, on or before March 5, 2010, the Company will send notice of its intent to file a certificate of dissolution with the Delaware Secretary of State on March 26, 2010, and that the notice shall indicate that the certificate of dissolution will not be effective until June 24, 2010. Accordingly, in a press release issued on March 5, 2010, the Company announced that it intended to file a certificate of dissolution with the Delaware Secretary of State on March 26, 2010 and that such certificate of dissolution would not be effective until June 24, 2010.

After the Second Annual Meeting Order issued, the Company filed an emergency motion for temporary relief (*Motion for Relief*) requesting that the Fifth District Court of Appeals of Texas at Dallas (the *Court of Appeals*) void the Second Annual Meeting Order. On March 3, 2010, the Court of Appeals issued a memorandum opinion in which the Court of Appeals granted the Company's Motion for Relief and voided the Second Annual Meeting Order. The Court of Appeals' judgment taxes all costs of the appeal against the Red Oak Group. On March 4, 2010, the trial court entered its Order dissolving the Second Annual Meeting Order.

Pursuant to the Dissolution Stipulation and in accordance with its plan of dissolution, on March 26, 2010 the Company filed a certificate of dissolution with the Delaware Secretary of State which became effective on June 24, 2010. Accordingly, immediately after the close of business on June 24, 2010, the Company closed its stock transfer books and discontinued recording transfers of shares of its common stock. Since June 24, 2010, there has only been limited trading activity among street name holders on the OTCQB of beneficial interests held by the Company's stockholders at the time of dissolution.

On March 26, 2010, the Red Oak Group filed its Motion to Dismiss for Lack of Jurisdiction, for Leave to Amend Petition, Attorneys' Fees, and for a Final Order Granting Permanent Injunctive Relief (*State Motion to Dismiss*). By its State Motion to Dismiss, the Red Oak Group seeks an order that, among other things, sets the Company's annual stockholders' meetings for 2008 and 2009 fifty (50) days after the issuance of such an order and sets the record date thirty (30) days before such annual meeting. Following an April 7, 2010 hearing before the court on the Red Oak Group's State Motion to Dismiss, the Court set the case for trial on May 24, 2010. On May 19, 2010, the Red Oak Group filed its Unopposed Motion for Voluntary Dismissal. On June 18, 2010, the court signed the Order of Dismissal.

**Phillips/Moorehead State Court Action**

On June 23, 2010, Company stockholders Ron Phillips and Scott Moorehead, putative plaintiffs, filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 298th District Court of Dallas County, Texas. The petition alleges that Messrs. Kaiser, Durham, and Tornek entered into self-dealing transactions at the expense of the Company and its stockholders and violated their fiduciary duties of loyalty, independence, due care, good faith, and fair dealing. Among other things, the petition also seeks the rescission of the Company's Long Term Incentive Plan and the Rights Plan, an award of compensatory and punitive damages, and the appointment of a trustee or conservator to oversee the windup and dissolution of the Company. No assurance can be given of the effect that the newly filed state court lawsuit will have on the Company, its financial position or its results of operations.

**Summit Litigation**

On August 31, 2010, CLST Holdings, Inc., CLST Financo, Inc., and CLST Asset II, LLC (the *CLST Parties*) filed a lawsuit in the 101st Judicial District Court of Dallas County, Texas against Summit Alternative Investments, LLC, Summit Consumer Receivables Fund, L.P., SSPE, LLC, SSPE Investment Trust I, Eric J. Gangloff, and Wayne M. Crane (the *Summit Parties*). The lawsuit arises from the Company's purchase of receivables, installment sales contracts, and related assets under the Trust II Purchase Agreement. The CLST Parties allege that certain receivables sold by the Summit Parties failed to meet certain agreed upon criteria, thus violating the Trust II Purchase Agreement and other related agreements between the parties. The CLST Parties have asserted claims against the Summit Parties for common law fraud, negligent misrepresentation, violations of the Securities Act, violations of the Texas Securities Act, and breach of contract. The CLST Parties have demanded a jury trial.

**(6) Subsequent Events.**

The Trust II Credit Agreement matured on September 28, 2010 and has not been repaid. The Company is in discussions with its lenders to resolve the repayment of borrowings currently due under the Trust II Credit Agreement and any defaults under the Trust



Table of Contents

I Credit Agreement. Those discussions are ongoing and the Company does not expect that its lenders will enforce any available foreclosure rights they may have on the assets of Trust I and Trust II while negotiations are proceeding. The Company has engaged Raymond James & Associates, Inc. to assist the Company in these lender negotiations and to seek replacement financing for borrowings under the Trust II Credit Agreement.

Table of Contents

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations section and audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the fiscal year ended November 30, 2009 filed with the Securities and Exchange Commission ( *SEC* ) and with the unaudited consolidated financial statements and related notes thereto presented in this Form 10-Q/A.

**Cautionary Statement Regarding Forward-Looking Statements**

Certain of the matters discussed in this Form 10-Q/A may constitute forward-looking statements for purposes of the Securities Act of 1933, as amended (the *Securities Act* ), and the Securities Exchange Act of 1934, as amended (the *Exchange Act* ), and, as such, may involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance, litigation results or achievements of CLST Holdings, Inc. (the *Company* ) to be materially different from future results, performance or achievements expressed or implied by such forward-looking statements. When used in this report, the words anticipates, estimates, believes, continues, expects, intends, may, might, should, likely, and similar expressions are intended to be among the statements that identify forward-looking statements. When we make forward-looking statements, we are basing them on our management's beliefs and assumptions, using information currently available to us. Although we believe that the expectations reflected in the forward-looking statements are reasonable, these forward-looking statements are subject to risks, uncertainties and assumptions. Statements of various factors that could cause the actual results, performance or achievements of the Company or future events relating to the Company to differ materially from the Company's expectations ( *Cautionary Statements* ) are disclosed in this report, including, without limitation, those discussed in the Item 1A, Risk Factors of our Annual Report on Form 10-K for the fiscal year ended November 30, 2009, those statements made in conjunction with the forward-looking statements and otherwise herein. All forward-looking statements attributable to the Company are expressly qualified in their entirety by the Cautionary Statements. We have no intention, and disclaim any obligation, to update or revise any forward-looking statements, whether as a result of new information, future results or otherwise.

**Overview**

*Sales Transactions*

During 2006 and 2007, the Company consummated a series of transactions to sell substantially all of its United States and Miami-based Latin American operations and its assets in both Mexico and Chile. For more information regarding these sales transactions please refer to Business Sale of Operations in Fiscal 2007 in the Company's Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

*Portfolio Transactions*

From November 2008 through February 2009, the Company consummated three acquisitions of consumer notes receivable portfolios. On November 10, 2008, the Company, through CLST Asset I, LLC ( *CLST Asset I* ), a wholly owned subsidiary of CLST Financo, Inc. ( *Financo* ),

which is one of our direct, wholly owned subsidiaries, entered into a purchase agreement to acquire all of the outstanding equity interests of FCC Investment Trust I ( *Trust I* ) from a third party (the *Trust I Purchase Agreement* ). The purchase price payable in the Trust I Purchase Agreement was financed pursuant to the terms and conditions set forth in the credit agreement, dated November 10, 2008, among Trust I, Fortress Credit Co LLC, as lender ( *Fortress* ), FCC Finance, LLC ( *FCC* ), as the initial servicer, the backup servicer, and the collateral custodian (the *Trust I Credit Agreement* ). On December 12, 2008 we, through CLST Asset Trust II ( *Trust II* ), a newly formed trust wholly owned by CLST Asset II, LLC ( *CLST Asset II* ), a wholly owned subsidiary of Financo, entered into a purchase agreement (the *Trust II Purchase Agreement* ) to acquire certain receivables, installment sales contracts and related assets owned by SSPE Investment Trust I ( *SSPE Trust* ) and SSPE, LLC ( *SSPE* ). Funding for Trust II included a non-recourse, revolving loan, which Trust II entered into with Summit Consumer Receivables Fund, L.P. ( *Summit* ), as originator, and SSPE and SSPE Trust, as co-borrowers, Summit and Eric J. Gangloff, as Guarantors, Fortress Credit Corp. ( *Fortress Corp.* ), as the lender, Summit Alternative Investments, LLC, as the initial servicer, and various other parties ( *Trust II Credit Agreement* ). On February 13, 2009, we, through CLST Asset III, LLC ( *CLST Asset III* ), a newly formed, wholly owned subsidiary of Financo, entered into a purchase agreement to acquire certain assets owned by Fair Finance Company, an Ohio corporation ( *Fair* ), James F. Cochran, then Chairman and Director of Fair, and by Timothy S. Durham, then Chief Executive Officer and Director of Fair and an officer, director and stockholder of our Company (the *Trust III Purchase Agreement* ). Messrs. Durham and Cochran own all of the outstanding equity of Fair. For more information regarding each of these acquisitions please refer to Business 2009 Business in the Company s Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

Table of Contents

*Plan of Dissolution*

As we have previously disclosed, the proxy statement we filed with the SEC on February 20, 2007 describes a proposal for a plan of dissolution, which provides for the complete liquidation and dissolution of the Company after the completion of the sale of the Company's operations in the United States (subject to abandonment by the Company's Board of Directors in the exercise of their fiduciary duties). On March 28, 2007, our stockholders approved the plan of dissolution in addition to the sale of substantially all of the Company's operations in the United States and Mexico. In the plan of dissolution approved by our stockholders, we stated that no distribution of proceeds from such sales would be made until the investigation by the SEC was resolved. On June 26, 2007, we received a letter from the staff of the SEC giving notice of the completion of their investigation with no enforcement action recommended to the SEC. Therefore, on June 27, 2007, our Board of Directors (the **Board**) declared a cash distribution of \$1.50 per share on Common Stock to stockholders of record as of July 9, 2007. On July 19, 2007, we issued the \$1.50 per share dividend in the total amount of \$30.8 million. Then, on November 1, 2007 we paid an additional \$0.60 per share dividend to stockholders which brings the cumulative dividends paid to stockholders to \$2.10 per share or approximately \$43.2 million. The amount and timing of any additional distributions paid to stockholders in connection with the liquidation and dissolution of the Company are subject to uncertainties and depend on the resolution of certain contingencies more fully described in this Form 10-Q/A, in the proxy statement and elsewhere in our Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

As permitted by the plan of dissolution, on March 26, 2010 the Company filed a certificate of dissolution with the Delaware Secretary of State which became effective on June 24, 2010. As a result of the effectiveness of the certificate of dissolution, the Company was dissolved and, except to the limited extent provided for by Delaware law, its corporate existence ceased. Among the effects of dissolution on a corporation are that the transferrable character of its equity securities is destroyed and the corporation may no longer issue additional capital stock. Accordingly, immediately after the close of business on June 24, 2010, the Company closed its stock transfer books and discontinued recording transfers of shares of its common stock. However, following June 24, 2010, there has been limited trading on the OTCQB of what purports to be the Company's common stock. Because the common stock, or the rights that its holders now have as a result of the dissolution of the Company, are not in fact transferrable, this trading represents trading of the beneficial interests held by the Company's stockholders at the time of the dissolution, among street name holders of those rights. Since the Company's stock transfer books are closed, none of the purchasers of the rights changing hands on the OTCQB would be able to obtain, should they so desire, a certificate representing ownership of a share of the Company's common stock.

Dissolution is the termination of a corporation's existence as a legal entity. After a certificate of dissolution of a corporation becomes effective, the corporate existence is terminated, and the corporation has three years to liquidate its assets, prosecute and defend suits, satisfy or provide for its liabilities, including contingent liabilities, to the extent of the corporation's assets, and distribute the net proceeds or the assets in kind, if any, to its stockholders. During this time period, the corporation must cease to carry on the business for which it was established, except as may be necessary or incidental to the winding up of the corporation's affairs. With respect to any action, suit or proceeding begun by or against the corporation either pre-dissolution or within the three-year period after dissolution, the action survives the dissolution. The corporation will continue to exist beyond the three-year period solely for the purpose of such action, suit or proceeding. We expect that it could take a couple of years for the Company to complete its plan of dissolution and make final liquidating distributions to its stockholders. Consistent with the plan of dissolution, the Company is considering whether it is possible, and if it would be in the best interest of the Company and its stockholders, to de-register with the SEC and thereby suspend the Company's responsibilities to file reports with the SEC or to obtain relief from the SEC from the requirement to file Form 10-Ks and Form 10-Qs.

During 2008, we performed a detailed review and analysis of the Company's historical taxnet operating loss carryforwards (the **NOLs**). We believe in many circumstances the NOLs, which amounted to approximately \$127.6 million as of August 31, 2010, and begin to expire after November 30, 2020, are available to offset future income. However, issuances of our stock, sales or other dispositions of our stock by certain significant stockholders, certain acquisitions of our stock and issuances, sales or other dispositions or acquisitions of interests in certain significant stockholders prior to the filing of our certificate of dissolution could have triggered an ownership change, and we may have no knowledge of and/or little or no control over any such events. If such an ownership change were to occur, we would be severely limited with

respect to our use of NOLs and certain other tax attributes to offset our taxable income, which could result in a significant increase in our future tax liability and could negatively affect our financial condition, results of operation and the amount of any liquidating distributions. As of August 31, 2010, approximately 30% - 34% of the change in control had occurred historically. If an additional approximate 16% - 20% change in control occurs in the future, as determined pursuant to Internal Revenue Service regulations, the Company could lose substantially all of the potential value of the NOLs. These percentages are based on information obtained through public filings and notices received by the Company directly from certain stockholders and may not necessarily reflect all transactions that would be included in determining the status of the Company's change of control.

We have continued to wind down aspects of our businesses, including dissolving some of our subsidiaries and continuing to try to collect our remaining non-cash assets. In addition, we have continued to review our liabilities and seek to satisfy or resolve those that we can in a favorable manner. See Item 1 Business 2009 Business of our Annual Report on Form 10-K for the fiscal year ended November 30, 2009 for further discussion with respect to our activities in this regard. At the time of the Company's analysis of the NOLs, we expected that it could take several years to implement the plan of dissolution because of the lengthy process of obtaining sufficient information regarding all of our liabilities to pay and appropriately provide for them as required under the plan of dissolution and the time necessary to complete the governmental requirements for dissolution. As a result, our Board focused on ways to generate higher returns on the Company's cash and other assets in order to better offset the Company expenses and to take advantage of the favorable tax treatment provided by our NOLs. Section 3 of the plan of dissolution states that we may not engage in any business activities except to the extent necessary to preserve the value of the Company's assets, wind up the Company's affairs, and distribute the Company's assets. Our Board determined to acquire several portfolios of receivables with the intention of generating a higher rate of return on our assets than we were receiving on our cash and cash equivalents balances which were held in money market accounts or short term certificates of deposit, earning approximately 1% (current interest rates are now close to 0%).

Table of Contents

Our Board believed that each of these acquisitions would provide a better investment return for our stockholders when compared to the low interest rates available on our cash investments and other investment alternatives although the acquisitions would involve a higher risk profile than traditional cash deposits and other cash equivalents positions. At the time we began looking at purchasing these portfolios during the second and third quarters of 2008, the credit markets became significantly impaired, and the viability of many banks and other financial institutions was in question. The Company's cash was held in one bank subject to the limited protection of FDIC coverage. The Board considered, among other things, spreading the Company's cash among over a dozen financial institutions. However, the Board did not believe spreading the Company's cash among many different banks to be practical or cost efficient. In addition, the Board considered various cash strategies including investing in a ladder of U.S. Treasury securities (securities of varying maturities) which would have resulted in higher yields than cash deposits, but would have required the Company to hold those securities in a brokerage firm and pay that firm a fee to arrange the transactions. The Board did not believe that the increased yield provided by a ladder of U.S. Treasury securities, after associated fees and administrative costs, was likely to be significantly better than that of cash deposits, and did not believe that interest from U.S. Treasury securities would allow the Company to use its NOLs to shield income from taxes. Finally, the Board was unsure how to assess the brokerage and custody risks associated with holding a ladder of U.S. Treasury securities through third parties, and felt that the risk was similar to that associated with commercial banks at the time.

Our Board understood that to obtain higher returns on its investments, the Company would have to assume a higher risk of loss. The Board believed that the opportunity offered by these purchases to earn higher returns than offered by cash and demand deposits, would offset the increased risks, and offer the Board a way of maximizing the value of the Company for the stockholders. In addition, these investments offered the Company an opportunity to utilize its NOLs if the returns resulted in positive income for the Company. The portfolio purchases the Company made were financed in part by borrowed money. Using borrowed money to purchase an income generating asset increases the return on investment, but increases the risk of loss on that investment. The Board carefully considered the amount of leverage in each of its portfolio purchases, believing each investment would be able to generate sufficient income to pay interest and principal on the debt, and still produce an attractive return for the Company and its stockholders. In considering the risk associated with leverage, the Board considered a number of different scenarios for performance of the investments, including the risk associated with increased default rates. The Board did not expect default rates to increase to current levels, but did consider that and other possibilities. In addition, the Board considered the costs associated with investments in our portfolios, including the ongoing costs of paying a servicer to service the portfolio, as part of its consideration of the overall potential return associated with those investments.

When we purchased Trust I, the historical annualized default rate for the previous three years for the portfolio was approximately 4%, which was the basis for assessing the creditworthiness of the assets included in CLST Asset I. Beginning in the third quarter of 2009 and continuing through the third quarter of 2010, we saw the annualized default rate increase, reaching as high as 15.8% in April 2010; accordingly, we have been increasing our allowances to reflect this change.

Upon examination of Trust II and CLST Asset III, we believe that the circumstances of these portfolios are different from those of Trust I. As of the date we acquired Trust I, approximately 39% of the receivables in the Trust I portfolio had credit scores higher than 676. Trust II contains new originations with higher credit requirements than the requirements for the Trust I portfolio. Since Trust II is comprised of new loans, the Company has managed the originations such that almost 65% of the new loans have credit scores higher than 680. Further, we acquired the Trust I portfolio at a discount of approximately 1.7% and acquired the Trust II portfolio at a discount of approximately 8.7%. The difference in the purchase discounts between CLST Asset I and CLST Asset II was impacted by the tightening of the credit markets between the time of these two acquisitions. Therefore the Trust II portfolio has a very different risk profile when compared to Trust I because of the better customer credit profile of Trust II customers and the larger purchase discount received. The sellers of the CLST Asset III portfolio have retained the risk of collectability of the receivables in that portfolio for up to an amount equal to the currently outstanding principal amount of the notes issued by the Company to the sellers. At the time of the closing of the acquisition of the CLST Asset III portfolio, the notes issued to the sellers represented approximately 25% of the total purchase price of the portfolio of approximately \$3.6 million. Since the principal balance of the notes declines over time as payments are made by the Company to the sellers, future defaulted receivables can be offset only against the then remaining balance of the notes issued to the sellers. As of August 31, 2010, all remaining amounts due to the sellers of the CLST Asset III portfolio have been offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted. However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be.

Because the Trust II Credit Agreement matured on September 28, 2010 and has not been repaid and the Company has received notices of default with respect to the Trust I Credit Agreement and Trust II Credit Agreement and is in discussions with its lenders regarding the facts supporting its lenders' actions and the relationship between CLST Asset I and CLST Asset II and Fortress generally, the Company cannot give any assurance that the portfolios can be sold on favorable terms or within any particular time frame. The Company's ability to execute an orderly sale of the portfolios may be negatively impacted by the maturity of the Trust II Credit Agreement and the current defaults of the Trust I Credit Agreement and the Trust II Credit Agreement as a result of higher than anticipated notes receivable defaults. The Company is currently in discussions with its lenders to resolve repayment of amounts due.

Table of Contents

under the Trust II Credit Agreement and any defaults under these credit agreements. Those discussions are ongoing and the Company does not expect that its lenders will enforce any available foreclosure rights they may have on the assets of Trust I and Trust II while negotiations are proceeding. The Company has engaged Raymond James & Associates, Inc. to assist the Company in these lender negotiations and to seek replacement financing for borrowings under the Trust II Credit Agreement.

**Discussion of Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting policies that are described in the notes to the consolidated financial statements. The preparation of the consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We continually evaluate our judgments and estimates in determination of our financial condition and operating results. Estimates are based on information available as of the date of the financial statements and, accordingly, actual results could differ from these estimates, sometimes materially. Critical accounting policies and estimates are defined as those that are both most important to the portrayal of our financial condition and operating results and require management's most subjective judgments. The most critical accounting policies and estimates are described below.

***Revenue Recognition***

Revenues, which consist of interest earned, late fees and other miscellaneous charges, are recorded as earned from notes receivable. Revenues are not accrued on accounts without payment activity for over 120 days and 90 days for CLST Asset I and CLST Asset II, respectively, unless payment activity resumes.

***Notes Receivable***

Notes receivable are recorded at the historical cost paid at the date of acquisition net of any purchase discounts. Subsequent to the date of acquisition, notes receivable are reduced by any principal payments made by the customer. Purchase discounts are recorded based on the negotiated difference between the face value and the amount paid for the notes receivable. Purchase discounts are recognized as revenue, using the effective interest method, as principal payments are collected.

The Company establishes an allowance for doubtful accounts for receivables where the customer has not made a payment for the most recent 120 day period for CLST Asset I and the most recent 90 day period for CLST Asset II and CLST Asset III. The Company specifically analyzes notes receivable using historical activity, current economic trends, changes in its customer payment terms, recoveries of previously reserved notes and collection trends when evaluating the adequacy of its allowance for doubtful accounts. Any change in the assumptions used in analyzing a specific note receivable may result in an additional allowance for doubtful accounts being recognized in the period in which the change occurs. During the fourth quarter of 2009, the Company modified its reserve policy due to recent market trends. Additional reserves are accrued based on account balances that are over 60 days past due with the reserve amount dependent on the overall performance of the portfolio. The Company may also establish an additional reserve for any portfolio that, in management's judgment, may need to be discounted at a future date in order to sell the portfolio in its entirety. Any reserve amount may be reduced based upon any offset rights or claims the Company may have against parties who initially sold the portfolio to the Company. The Company may from time to time make additional increases to the



allowance based on the foregoing factors. Once a note receivable has been reserved due to nonpayment, the Company will no longer accrue, for financial reporting purposes, interest earned on the note receivable. Should the note receivable return to a performing status, then the Company will resume accruing interest on the note receivable. Recoveries are recorded against the allowance when payments are received. Notes receivable are charged off against the allowance after all means of collection have been exhausted and a legal determination has been rendered that less than the full amount of the note receivable will be collected. Recoveries of notes receivable, which were previously charged off, are recorded to income when payments are received.

## **Recent Developments**

### *Subsidiaries*

We are working steadily to complete a long list of actions necessary to complete the wind down of our historical business in an orderly fashion. Completing the wind down is a cumbersome task that requires many steps and may take a significant amount of time. These steps include dissolving numerous subsidiaries, resolving pending litigation and completing various regulatory filings and other requirements. We cannot predict how long, how time-consuming or how costly resolution of the litigation matters will be. To date, we have completed and filed final sales tax returns and franchise tax returns for most of our entities. We have also completed the requirements to withdraw most of our entities from doing business in multiple state jurisdictions in the U.S. Furthermore, we are continuing to dissolve our foreign and domestic subsidiaries pursuant to the plan of dissolution.

Table of Contents

In order to protect the Company's cash and other assets from any actual or potential liabilities of the Company's direct and indirect subsidiaries, we will not dissolve our inactive direct or indirect domestic or foreign subsidiaries until the actual and contingent liabilities of each such subsidiary have been resolved or contingency reserves have been set aside sufficient to pay or make reasonable provision to pay all such subsidiary's claims and obligations in accordance with applicable law. Specifically, we will not dissolve Audiomex Export Corp., National Auto Center, Inc. and CLST-NAC, Ltd., which are direct parties to, and NAC Holdings, Inc., which is an indirect party to, the arbitration proceeding for our claim in Mexico against the purchasers of the sale of our assets in Mexico, until the final resolution and payment of that claim. The arbitration proceeding was held in Mexico City, Mexico in October 2009 and the arbitration panel issued their award dated July 15, 2010, as disclosed in the Company's Current Report on Form 8-K filed with the SEC on July 29, 2010. The Company is waiting for payment to be received under the arbitration award before these subsidiaries are dissolved.

In certain jurisdictions, the dissolution process is an extended one. We completed the dissolution of our subsidiaries in the United Kingdom and Guatemala in February 2008 and March 2009, respectively, and of CLST-NAC Fulfillment, Ltd., a Texas limited partnership and indirect subsidiary of the Company, in September 2009. Furthermore, we completed the merger of CLST Fulfillment, Inc., a Delaware corporation, into its parent, National Auto Center, Inc., a Delaware corporation and our wholly owned subsidiary, effective September 10, 2009. In addition we have made demands on the purchaser of our former Colombian subsidiary for the documents needed to divest our remaining minority interest in that subsidiary. Further, we have submitted documents to several governmental authorities in El Salvador as required to dissolve our dormant entity in El Salvador. On June 30, 2010 we obtained one of three requisite tax clearances, and we are continuing the process of publishing notices, preparing registration documents, obtaining additional tax and governmental approvals, and working to complete the many steps necessary to dissolve this dormant entity.

During the second quarter of 2009 we collected \$61,000, representing the final payment of the original note amount of \$720,869 from the 2004 sale of our Colombian operations. The note had been fully reserved and the payment received was recorded in general and administrative expenses.

The Company made substantial progress in dissolving its subsidiaries during January and February 2010. In January 2010, the Company dissolved each of CLST International Corporation/Asia, a Delaware corporation, CellStar Philippines, Inc., a Philippines corporation, and CellStar Netherlands Holdings, B.V, a Netherlands company. In February 2010, the Company dissolved CellStar Holdings AB (Sweden).

As a result of the Company's progress, as of the date of the filing of this Form 10-Q/A, the Company had only five non-operating U.S. entities remaining to be dissolved, four of which are direct and indirect parties to the Mexico arbitration discussed above and will not be dissolved until the final resolution and payment of that claim. All of the Company's foreign subsidiaries have been dissolved, with the exception of the one dormant entity in El Salvador that never conducted operations.

Table of Contents**Results of Operations**

The Company reported a net loss of \$0.7 million or \$0.03 per basic and diluted share, for the three months ended August 31, 2010, compared to a net loss of \$1.2 million, or \$0.05 per basic and diluted share for the same period last year. The decrease in net loss is primarily attributable to a decrease in our legal costs associated with the actions taken by Red Oak Fund, L.P. and certain of its affiliates ( *Red Oak* or the *Red Oak Group* ) in connection with the Federal Court Action and State Court Action resulting from the dismissal of the State Court Action on June 18, 2010 and the reimbursement of \$0.6 million under our directors and officers liability insurance policy for legal costs during the three months ended August 31, 2010 that were previously incurred and expensed by the Company. The decrease in net loss was offset in part by an increase in provision for doubtful accounts of approximately \$0.2 million and a decrease in revenues of approximately \$0.4 million during the same period.

The following table shows certain information as of August 31, 2010 for each of CLST Asset I, CLST Asset II and CLST Asset III. A more detailed description of the results for each of these entities is provided below. Amounts presented are in thousands, except for the approximate number of customer accounts and the average outstanding principal balance per account.

|   | CLST Asset I      |            | CLST Asset II     |            | CLST Asset III    |            |
|---|-------------------|------------|-------------------|------------|-------------------|------------|
|   | Principal Balance | % of Total | Principal Balance | % of Total | Principal Balance | % of Total |
| <b>Receivables Aging (Principal)</b>              |                   |            |                   |            |                   |            |
| Current 0-30 Days                                 | \$ 23,450         | 76.3%      | \$ 5,937          | 93.5%      | \$ 778            | 83.2%      |
| 31 - 60 Days                                      | 885               | 2.9%       | 82                | 1.3%       | 61                | 6.5%       |
| 61 - 90 Days                                      | 692               | 2.3%       | 43                | 0.7%       | 58                | 6.2%       |
| 91 + 120  | 538               | 1.7%       | 49                | 0.8%       | 38                | 4.1%       |
| 120+  | 5,182             | 16.9%      | 240               | 3.7%       |                   | 0.0%       |
| Total Receivables                                 | 30,747            | 100.0%     | 6,351             | 100.0%     | 935               | 100.0%     |
| Allowance for doubtful Accts                      | (5,971)           | -19.4%     | (293)             | -4.6%      | (38)              | -4.1%      |
| Net Receivables                                   | 24,776            | 80.6%      | 6,058             | 95.4%      | 897               | 95.9%      |
| Discount  | (427)             | -1.4%      | (525)             | -8.3%      | (28)              | -3.0%      |
| Acquisition fees                                  | 134               | 0.4%       | 21                | 0.3%       | 21                | 2.2%       |
| Total   | \$ 24,483         | 79.6%      | \$ 5,554          | 87.5%      | \$ 890            | 95.2%      |
| Accounts Receivable Other                         | \$                |            | \$ 100            |            | \$ 13             |            |
| Notes Payable and Loans Outstanding               | \$ 21,949         |            | \$ 4,041          |            | \$                |            |
| Approximate Number of Customer Accounts           | 4,653             |            | 900               |            | 726               |            |
| Average Outstanding Principal Balance per Account | \$ 6,608          |            | \$ 7,057          |            | \$ 1,288          |            |
|   | 101               |            | 91                |            | 28                |            |

|  |       |       |       |
|--|-------|-------|-------|
| Weighted Average Remaining Term, in Months |       |       |       |
| Weighted Average APR                       | 14.3% | 14.7% | 18.0% |

*Three Months Ended August 31, 2010, Compared to Three Months Ended August 31, 2009*

**Consolidated**

*Revenues.* Revenues, which primarily consist of interest and other charges earned from the Company's receivable portfolios, for the three months ended August 31, 2010 were \$1.3 million compared to \$1.8 million for the same period in 2009, and such decrease is due to the decrease in the outstanding principal balance of total notes receivable during the three months ended August 31,

Table of Contents

2010 compared to the three months ended August 31, 2009 as a result of principal payments on the notes receivable and increases in defaulted notes receivable. Revenues for the three months ended August 31, 2010 included \$1.0 million from CLST Asset I, \$0.2 million from CLST Asset II and \$0.1 million from CLST Asset III. Revenues for the three months ended August 31, 2009 included \$1.3 million from CLST Asset I, \$0.4 million from CLST Asset II and \$0.1 million from CLST Asset III.

*Loan Servicing Fees.* Loan servicing fees, which primarily consist of loan servicing fees and trust administration fees, were \$301,000 for the three months ended August 31, 2010 compared to \$235,000 for the same period in 2009. This increase is primarily due to higher costs associated with maintaining and collecting defaulted and delinquent receivables which increased by approximately \$4.2 million from August 31, 2009 to August 31, 2010. Additionally, prior to February 2010, the CLST Asset III portfolio was serviced by Fair at no charge to the Company per the terms of the Trust III Purchase Agreement. In February 2010, however, the Company began incurring loan servicing fees as a result of the transfer of the servicing of the CLST Asset III portfolio from Fair to Highlands Premier Acceptance Corp. and Highlands Financial Services, LLC (collectively referred to herein as **Highlands**). This transfer occurred due to Fair's inability to service the CLST Asset III portfolio after certain of its assets were seized by the FBI and other government agencies, including their servers, computers and other items used by Fair in the servicing of the CLST Asset III portfolio.

*Provision for Doubtful Accounts.* Provision for doubtful accounts was \$0.8 million for the three months ended August 31, 2010, compared to \$0.7 million for the same period in 2009. The increase primarily relates to an increase in the provision for doubtful accounts for CLST Asset I and CLST Asset II as a result of an increase in the default rates experienced beginning in the third quarter of 2009 and continuing through the second quarter of 2010. CLST Asset III established a \$38,000 provision for doubtful accounts as of August 31, 2010 which represents the allowance for doubtful accounts in excess of the amounts that have been offset against the notes payable to the sellers per the Trust III Purchase Agreement.

*Interest Expense.* Interest expense is incurred from borrowings under the credit facilities of CLST Asset I and CLST Asset II and the notes issued in connection with the CLST Asset III acquisition. Interest expense was \$523,000 for the three months ended August 31, 2010 compared to \$508,000 for the same period in 2009 and represented 40% and 29% of revenue, respectively. The increase in the interest expense as a percentage of revenue is primarily due to the 2% increase in the interest rate for borrowing under the Trust I Credit Agreement and the Trust II Credit Agreement as a result of the Company's defaults under these agreements. Interest expense for the three months ended August 31, 2010 was \$442,000 for CLST Asset I, \$79,000 for CLST Asset II and \$2,000 for CLST Asset III compared to \$420,000 for CLST Asset I, \$80,000 for CLST Asset II and \$8,000 for CLST Asset III for the same period in 2009.

*General and Administrative Expenses.* Our general and administrative expenses were \$0.3 million for the three months ended August 31, 2010 compared to \$1.5 million for the same period in 2009. This decrease is primarily the result of decreased legal, accounting and professional fees. Our legal and professional expenses during the three months ended August 31, 2010 were \$45,000 compared to \$1.3 million during the same period in 2009. Those fees relate primarily to defending against claims brought by the Red Oak Group against us and our directors in the State Court Action and the Federal Court Action. We have made a claim under our directors' and officers' liability insurance policy for reimbursement of amounts we are obligated under our certificate of incorporation and bylaws to advance to our directors for their defense costs associated with the Red Oak Group claims. Our carrier has agreed to reimburse us for those expenses in excess of our \$1 million self retention under the policy, subject to certain reservations of rights. During the second quarter of 2010, the Company's directors' and officers' liability insurance carrier began to reimburse the Company for amounts advanced to Messrs. Durham, Kaiser and Tornek in connection with their defense against claims brought by the Red Oak Group and began to pay certain attorneys' fees directly for services rendered. During the three months ended August, 31, 2010, the Company was reimbursed \$0.6 million for legal fees incurred and paid by the Company in prior quarters. These reimbursements and any future reimbursements received will offset the legal expenses incurred in general and administrative expenses.

*Other income, net.* Other income, net was \$1,000 for the three months ended August 31, 2010 compared to \$1,000 for the same period in 2009.

*Income taxes.* The Company recorded tax expense of \$20,000 for the three months ended August 31, 2010 compared to tax expense of \$9,000 for the same period in 2009.

***CLST Asset I***

For the three months ended August 31, 2010, collections for CLST Asset I were \$2.1 million, representing \$1.1 million of principal payments and \$1.0 million of interest payments and other charges compared to collections of \$2.9 million, representing \$1.6 million of principal payments and \$1.3 million of interest payments and other charges during the three months ended August 31, 2009. As of August 31, 2010, the aggregate outstanding principal balance of the notes receivable net of reserves and excluding certain accrued interest and deferred cost was \$24.8 million, which represents 60% of the original purchase price of \$41.0 million. The ending

Table of Contents

balance consisted of approximately 4,653 customer accounts, with an average outstanding principal balance per account of approximately \$6,608. The weighted average interest rate for these accounts was 14.3% as of August 31, 2010.

Total revenues for the three months ended August 31, 2010 were approximately \$1.0 million which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$1.4 million, which included a \$0.7 million provision for doubtful accounts, \$0.4 million of interest expense to Fortress, our lender, and \$0.2 million of servicing expense to FCC.

As of August 31, 2010, Trust I owed \$21.9 million to Fortress, representing 63% of the original loan amount.

***CLST Asset II***

For the three months ended August 31, 2010, collections for CLST Asset II were \$0.5 million, representing \$0.3 million of principal payments and \$0.2 million of interest payments and other charges compared to collections of \$0.9 million, representing \$0.6 million of principal payments and \$0.3 million of interest payments and other charges during the three months ended August 31, 2009. As of August 31, 2010, the aggregate outstanding principal balance of the notes receivable net of reserves and excluding certain accrued interest and deferred cost was \$6.1 million, which represents 64% of the original purchase price of \$9.6 million. The ending balance consisted of approximately 900 customer accounts, with an average outstanding principal balance per account of approximately \$7,057. The weighted average interest rate for these accounts was 14.7% as of August 31, 2010.

Total revenues for the three months ended August 31, 2010 were approximately \$272,000 which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$217,000, which included a \$69,000 provision for doubtful accounts, \$79,000 of interest expense to Fortress Corp., our lender, and \$69,000 of servicing expense to FCC.

As of August 31, 2010, CLST Asset II owed \$4.0 million to Fortress Corp., representing 63% of the original loan amount.

***CLST Asset III***

For the three months ended August 31, 2010, collections for CLST Asset III were \$192,000, representing \$142,000 of principal payments and \$50,000 of interest payments and other charges compared to collections of \$441,000, representing \$347,000 of principal payments and \$94,000 of interest payments and other charges during the three months ended August 31, 2009. As of August 31, 2010, the aggregate outstanding principal balance of the notes receivable net of reserves and excluding certain accrued interest and deferred cost was \$0.9 million, which represents 25% of the original purchase price of \$3.6 million. The ending balance consisted of approximately 726 customer accounts, with an average outstanding principal balance per account of approximately \$1,288. The weighted average interest rate for these accounts was 18.0% as of August 31, 2010.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

Total revenues for the three months ended August 31, 2010 were approximately \$51,000 which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$62,000, which included a \$38,000 provision for doubtful accounts, \$2,000 of interest expense on the Notes, and \$22,000 of servicing expense to Highlands.

Defaults of \$112,000 during the three months ended August 31, 2010 were applied to the Notes payable to the sellers per the Trust III Purchase Agreement. During the three months ended August 31, 2010, the Notes payable to the sellers were completely offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted. However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be.

### *Nine Months Ended August 31, 2010, Compared to Nine Months Ended August 31, 2009*

#### **Consolidated**

*Revenues.* Revenues, which primarily consist of interest and other charges earned from the Company's receivable portfolios, for the nine months ended August 31, 2010 were \$4.1 million compared to \$5.2 million for the same period in 2009. This decrease is due to the decrease in the outstanding principal balance of total notes receivable during the nine months ended August 31, 2010 compared to the nine months ended August 31, 2009 as a result of principal payments on the notes receivable and increases in defaulted notes receivable. Revenues for the nine months ended August 31, 2010 included \$3.1 million from CLST Asset I, \$0.8 million from CLST Asset II and \$0.2 million from CLST Asset III. Revenues for the nine months ended August 31, 2009 included \$4.2 million from CLST Asset I, \$0.8 million from CLST Asset II and \$0.2 million from CLST Asset III.



Table of Contents

*Loan Servicing Fees.* Loan servicing fees, which primarily consist of loan servicing fees and trust administration fees, were \$881,000 for the nine months ended August 31, 2010 compared to \$621,000 for the same period in 2009. This increase is primarily due to higher costs associated with maintaining and collecting defaulted and delinquent receivables which increased by approximately \$4.2 million from August 31, 2009 to August 31, 2010. Additionally, prior to February 2010, the CLST Asset III portfolio was serviced by Fair at no charge to the Company per the terms of the Trust III Purchase Agreement. In February 2010, however, the Company began incurring loan servicing fees as a result of the transfer of the servicing of the CLST Asset III portfolio from Fair to Highlands. This transfer occurred due to Fair's inability to service the CLST Asset III portfolio after certain of its assets were seized by the FBI and other government agencies, including their servers, computers and other items used by Fair in the servicing of the CLST Asset III portfolio.

*Provision for Doubtful Accounts.* Provision for doubtful accounts was \$2.6 million for the nine months ended August 31, 2010, compared to \$2.0 million for the same period in 2009. The increase primarily relates to an increase in the provision for doubtful accounts for CLST Asset I of \$2.3 million during the nine months ended August 31, 2010 when compared to the provision of \$1.9 million for the nine months ended August 31, 2009. This increase is a result of an increase in the default rates experienced beginning in the third quarter of 2009 and continuing through the second quarter of 2010. The increases in the provision for doubtful accounts for the nine months ended August 31, 2010 also included an increase to \$0.2 million for CLST Asset II compared to \$20,000 for the nine months ended August 31, 2009. CLST Asset III established a \$38,000 provision for doubtful accounts as of August 31, 2010 which represents the allowance for doubtful accounts in excess of the amounts that have been offset against the notes payable to the sellers per the Trust III Purchase Agreement.

*Interest Expense.* Interest expense is incurred from borrowings under the credit facilities of CLST Asset I and CLST Asset II and the notes issued in connection with the CLST Asset III acquisition. Interest expense was \$1.6 million for the nine months ended August 31, 2010 compared to \$1.6 million for the same period in 2009 and represented 40% and 31% of revenue, respectively. The increase in the interest expense as a percentage of revenue is primarily due to the 2% increase in the interest rate for borrowing under the Trust I Credit Agreement and the Trust II Credit Agreement as a result of the Company's defaults under these agreements. Interest expense for the nine months ended August 31, 2010 was \$1.4 million for CLST Asset I, \$0.2 million for CLST Asset II and \$12,000 for CLST Asset III compared to \$1.4 million for CLST Asset I, \$0.2 million for CLST Asset II and \$20,000 for CLST Asset III for the same period in 2009.

*General and Administrative Expenses.* Our general and administrative expenses were \$3.2 million for the nine months ended August 31, 2010 compared to \$3.8 million for the same period in 2009. This decrease is the result of decreased legal, accounting and professional fees. Our legal and professional expenses during the nine months ended August 31, 2010 were \$2.4 million compared to \$3.3 million during the same period in 2009. Those fees relate primarily to defending against claims brought by the Red Oak Group against us and our directors in the State Court Action and the Federal Court Action. We have made a claim under our directors' and officers' liability insurance policy for reimbursement of amounts we are obligated under our certificate of incorporation and bylaws to advance to our directors for their defense costs associated with the Red Oak Group claims. Our carrier has agreed to reimburse us for those expenses in excess of our \$1 million self retention under the policy, subject to certain reservations of rights. During the second quarter of 2010, the Company's directors' and officers' liability insurance carrier began to reimburse the Company for amounts advanced to Messrs. Durham, Kaiser and Tornek in connection with their defense against claims brought by the Red Oak Group and began to pay certain attorneys' fees directly for services rendered. During the nine months ended August 31, 2010, the Company was reimbursed \$1.3 million for legal fees incurred and paid by the Company. These reimbursements and any future reimbursements received will offset the legal expenses incurred in general and administrative expenses.

*Other income, net.* Other income, net was \$44,000 for the nine months ended August 31, 2010 compared to \$10,000 for the same period in 2009. This increase is primarily the result of accumulated foreign currency translation adjustments of \$40,000 that were written-off as a result of the dissolution of CellStar Netherlands Holdings, B.V.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

*Income taxes.* The Company recorded tax expense of \$34,000 for the nine months ended August 31, 2010 compared to tax expense of \$17,000 for the same period in 2009.

### *CLST Asset I*

For the nine months ended August 31, 2010, collections for CLST Asset I were \$6.8 million, representing \$3.7 million of principal payments and \$3.1 million of interest payments and other charges compared to collections of \$9.0 million, representing \$5.0 million of principal payments and \$4.0 million of interest payments and other charges during the nine months ended August 31, 2009.

Total revenues for the nine months ended August 31, 2010 were approximately \$3.1 million which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$4.4 million, which included a \$2.3

Table of Contents

million provision for doubtful accounts, \$1.4 million of interest expense to Fortress, our lender, and \$0.7 million of servicing expense to FCC.

***CLST Asset II***

For the nine months ended August 31, 2010, collections for CLST Asset II were \$1.7 million, representing \$1.0 million of principal payments and \$0.7 million of interest payments and other charges compared to collections of \$2.5 million, representing \$1.9 million of principal payments and \$0.6 million of interest payments and other charges during the nine months ended August 31, 2009.

Total revenues for the nine months ended August 31, 2010 were approximately \$0.8 million which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$0.6 million, which included a \$0.2 million provision for doubtful accounts, \$0.2 million of interest expense to Fortress Corp., our lender, and \$0.2 million of servicing expense to FCC.

***CLST Asset III***

For the nine months ended August 31, 2010, collections for CLST Asset III were \$0.6 million, representing \$0.5 million of principal payments and \$0.1 million of interest payments and other charges compared to collections of \$1.6 million, representing \$1.4 million of principal payments and \$0.3 million of interest payments and other charges during the nine months ended August 31, 2009.

Total revenues for the nine months ended August 31, 2010 were approximately \$161,000 which primarily consisted of interest income collected from the notes receivable. Operating expenses for this period were \$109,000, which included a \$38,000 provision for doubtful accounts, \$12,000 of interest expense on the Notes, and \$59,000 of servicing expense to Highlands.

Defaults of \$373,000 during the nine months ended August 31, 2010 were applied to the Notes payable to the sellers per the Trust III Purchase Agreement. During the nine months ended August 31, 2010, the Notes payable to the sellers were completely offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted. However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be

**Liquidity and Capital Resources**

Subsequent to the sale of our discontinued operations in March 2007 and prior to the acquisition of Trust I in November 2008, we met our cash needs with existing funds and interest and investment income generated by our cash and cash equivalents. As of August 31, 2010, we had cash and cash equivalents of approximately \$2.4 million, down from \$4.8 million at November 30, 2009. Historically, we have invested our cash and cash equivalents in either money market accounts or short term Certificate of Deposits. The majority of our cash is invested in Texas Capital Bank, N.A. at a variable interest rate and in government repurchase contracts, where we are earning less than 1% per year. Each deposit of our

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

cash is FDIC insured or government insured. We financed our acquisitions of our receivables portfolios with cash, non-recourse debt, and the issuance of shares of our common stock. Since the acquisitions of our receivable portfolios, we use the income generated from these receivable portfolios, in addition to our cash and cash equivalents, to meet our cash needs.

The report of our independent registered public accounting firm with respect to our financial statements as of November 30, 2009 and for the year then ended contains an explanatory paragraph with respect to our ability to continue as a going concern. This concern has been raised due to the higher than anticipated defaults on the notes receivable included in CLST Asset I which has resulted in a default under the Trust I Credit Agreement and an approximately \$3.5 million increase in the allowance for doubtful accounts during the twelve months ended November 30, 2009, with an additional \$2.6 million increase in the allowance for doubtful accounts through August 31, 2010. As a result of the Company's default under the Trust I Credit Agreement, the amount due to Fortress under this agreement has been classified as current as of November 30, 2009 and August 31, 2010. The Company has also been engaged in several lawsuits which have resulted in the Company incurring significant legal fees. The combination of the increase in the allowance for doubtful accounts and high legal fees resulted in the Company incurring a net loss of approximately \$5.2 million and \$4.3 million during the twelve months ended November 30, 2009 and the nine months ended August 31, 2010, respectively. The Company is continuing discussions to resolve the defaults under the Trust I Credit Agreement and the Trust II Credit Agreement. The Company has made a claim under its directors' and officers' liability insurance policy for reimbursement of legal fees incurred in excess of our \$1.0 million self retention amount. During the second quarter of 2010, the Company's directors' and officers' liability insurance carrier began to reimburse the Company for a portion of the legal fees incurred and began to pay certain attorneys' fees directly for services rendered. During the three months and nine months ended August 31, 2010, the Company received \$0.6 million and \$1.3 million, respectively, for the reimbursement of legal fees incurred and paid by the Company. These reimbursements, and any future reimbursements received, will offset the legal expenses incurred in general and administrative expenses. It is uncertain whether

Table of Contents

the Company can continue as a going concern or continue long enough to allow for an orderly sale of the Company's portfolios if it continues to incur net losses and if the Company loses the CLST Asset I and CLST Asset II consumer receivables as a result of the defaults under the Trust I Credit Agreement and the Trust II Credit Agreement.

*Operating Activities.* The net cash provided by operating activities for the nine months ended August 31, 2010 was \$0.3 million compared to net cash used in operating activities of \$1.2 million for the same period in 2009. The primary reasons for this increase in cash from operating activities was due to the release of cash receipts from our consumer receivable portfolios that were withheld by FCC as a result of the Company's default under the Trust I Credit Agreement and a decrease in legal and professional expenses. The withheld funds were applied directly to the outstanding principal balance due to Fortress under the Trust I Credit Agreement. Our legal and professional expenses during the nine months ended August 31, 2010 were \$2.4 million compared to \$3.3 million during the same period in 2009. Partially offsetting this increase in cash from operating activities was an increase in net loss as a result of a decrease in revenue of approximately \$1.1 million during the nine months ended August 31, 2010 when compared to the nine months ended August 31, 2009. We have made a claim under our directors' and officers' liability insurance policy for reimbursement of amounts we are obligated under our certificate of incorporation and bylaws to advance to our directors for their defense costs associated with the Red Oak Group claims. Our carrier has agreed to reimburse us for those expenses in excess of our \$1 million self retention under the policy, subject to certain reservations of rights. During the second quarter of 2010, the Company's directors' and officers' liability insurance carrier began to reimburse the Company for amounts advanced to Messrs. Durham, Kaiser and Tornek in connection with their defense against claims brought by the Red Oak Group and began to pay certain attorneys' fees directly for services rendered. During the three months and nine months ended August 31, 2010, the Company was reimbursed \$0.6 million and \$1.3 million, respectively, for legal fees incurred and paid by the Company. These reimbursements and any future reimbursements received will offset the legal expenses incurred in general and administrative expenses. The Company has expended a significant amount of management time and resources in connection with Federal Court Action and the State Court Action. On June 18, 2010, the State Court Action was dismissed. However, on June 23, 2010 Ron Phillips and Scott Moorehead filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 298th District Court of Dallas County, Texas. No assurance can be given of the effect that the Federal Court Action and the newly filed state court lawsuit will have on the Company, its financial position or its results of operations.

*Investing Activities.* The net cash provided by investing activities for the nine months ended August 31, 2010 was \$5.0 million compared to net cash provided during the same period in 2009 of \$4.0 million. Principal collections from consumer receivables decreased from \$8.1 million during the nine months ended August 31, 2009 to \$5.0 million for the same period in 2010. The increase in net cash provided by investing activities from 2009 to 2010 is primarily a result of the fact that during the nine months ended August 31, 2009, the principal collections from consumer receivables were significantly offset by the \$4.0 million of cash used to purchase CLST Asset II and CLST Asset III. There was no similar investment of cash for the same period in 2010.

*Financing Activities.* The net cash used in financing activities for the nine months ended August 31, 2010 was \$7.7 million compared to \$6.8 million for the same period in 2009. The cash used in financing activities in the period was used to reduce the outstanding debt principal balance under both the Trust I Credit Agreement and Trust II Credit Agreement.

*Liquidity Sources.*

CLST Asset I. Our acquisition of Trust I was financed by approximately \$6.1 million of cash on hand and by a non-recourse, term loan of approximately \$34.9 million to Trust I by an affiliate of the seller of Trust I, pursuant to the terms and conditions set forth in the Trust I Credit Agreement. The loan matures on November 10, 2013 and bears interest at an annual rate of 5.0% over the LIBOR Rate (as defined in the Trust I Credit Agreement). Under the terms of the Trust I Credit Agreement, the net cash proceeds from the collection of consumer receivables held by Trust I in any particular month are remitted to the Company on or about the 20th day of the following month. As of August 31, 2010, the outstanding balance of our term loan was \$21.9 million, representing 63% of our original balance. During the nine months ended August 31,

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

2010, we retired approximately \$6.7 million of our obligation to Fortress, and we have paid \$1.4 million in interest expense, all from customer collections.

The obligations under the Trust I Credit Agreement are secured by a first priority security interest in substantially all of the assets of Trust I, including portfolio collections. An event of default occurs under the Trust I Credit Agreement if the three-month rolling average delinquent accounts rate exceeds 10.0% or the three-month rolling average annualized default rate exceeds 7.0%. As of August 31, 2010, these default rates were 8.55% and 10.32%, respectively.

On October 16, 2009, we received a notice of default from Fortress (the *Trust I Default Notice*) stating that an event of default had occurred and was continuing under the Trust I Credit Agreement. The Trust I Default Notice states that the three-month rolling average annualized default rate of the Trust I portfolio has exceeded 7.0%. As a result of the default, pursuant to the Trust I Credit Agreement, the interest rate payable by Trust I has increased by an additional 2% per annum, and all collections by Trust I above amounts retained to pay interest, fees, principal amortizations, and other charges that are normally remitted to the Company, are

Table of Contents

instead being retained by Fortress and applied to pay interest and reduce the outstanding principal under the Trust I Credit Agreement until the amount due has been reduced to zero. In addition, Fortress is entitled to foreclose on the assets of Trust I and sell them to satisfy amounts due it under the Trust I Credit Agreement, but Fortress has not sought to foreclose on the assets of Trust I. The obligations under the Trust I Credit Agreement are non-recourse and only Trust I is liable for amounts due Fortress under the Trust I Credit Agreement. Thus, although the Company could lose some or all of its investment in Trust I, the Company will not be obligated to pay any amounts due Fortress under the Trust I Credit Agreement. Discussions with Fortress regarding these matters and certain claims the Company may have against Fortress are ongoing. The Company does not expect that Fortress will foreclose on the assets of Trust I while negotiations are proceeding. As a result of this default, the entire balance of \$21.9 million due to Fortress under the Trust I Credit Agreement has been classified as current on the August 31, 2010 balance sheet. Had the Company not been in default under the Trust I Credit Agreement, \$17.0 million of the outstanding balance as of August 31, 2010 would have been classified as non-current.

We have the right to require the seller to repurchase any accounts, for the original purchase price applicable to such account, that do not satisfy certain specified eligibility requirements set out in the Trust I Purchase Agreement. If it is discovered by a party that a receivable account was not an Eligible Receivable as of the cut-off date of October 31, 2008, the seller is required to repurchase such receivable account unless such breach is remedied within thirty business days of notice of such breach. An account is not an Eligible Receivable if, as of October 31, 2008, such receivable account is, among other things, a defaulted receivable, subject to litigation, dispute or rights of rescission, setoff or counterclaim, or is not subject to a duly recorded and perfected lien. The Company believes that between \$1.3 million and \$2.2 million of receivables purchased were ineligible, as defined in the Trust I Purchase Agreement, at the time of purchase. Of these potentially ineligible receivables, approximately \$682,000 has become defaulted receivables. The Company has notified Fortress of these potentially ineligible receivables and discussions with Fortress are ongoing. The Company cannot predict when or if these matters will be resolved favorably or at all.

CLST Asset II. The Trust II became a co-borrower under a \$50 million credit agreement, which was reduced to a \$30 million commitment during the second quarter of 2009, that permits Trust II to use more than \$15 million of the aggregate availability under the revolving facility to purchase receivables. The Trust II Credit Agreement is effective as of December 10, 2008, and was entered into among the Trust II, FCC, the originator, SSPE Trust and SSPE, the co-borrowers (who are the sellers under the Trust II Purchase Agreement), Fortress Corp., the lender, FCC, the initial servicer, Lyons Financial Services, Inc., the backup servicer, Eric J. Gangloff, the guarantor, and U.S. Bank National Association, the collateral custodian. The non-recourse revolving facility was initially established by Summit, an affiliate of the sellers under the Trust II Purchase Agreement. Under the terms of the Trust II Credit Agreement, the net cash proceeds from the collection of consumer receivables held by Trust II in any particular month are remitted to the Company on or about the 20th day of the following month. The revolver matured on September 28, 2010 and has not been repaid. The revolver bears interest at an annual rate of 4.5% over the LIBOR Rate (as defined in the Trust II Credit Agreement). The Trust II pays an additional fee to the co-borrowers equal to an annual rate of 0.5% for loans attributable to the Trust II equal to or below \$10 million and an annual rate of 1.5% for loans attributable to the Trust II in excess of \$10 million. In addition, a commitment fee is due to the lender equal to an annual rate of 0.25% of the unused portion of the maximum committed amount. During the nine months ended August 31, 2010, we retired approximately \$1.0 million of our obligation to Fortress Corp., and we have paid \$0.2 million in interest expense, all from customer collections.

The obligations under the Trust II Credit Agreement are secured by a first priority security interest in substantially all of the assets of the Trust II and the co-borrowers, including portfolio collections. An event of default occurs under the Trust II Credit Agreement if the three-month rolling average delinquent accounts rate exceeds 15.0% for Class A Receivables or 30.0% for Class B Receivables, or the three-month rolling average annualized default rate exceeds 5.0% for Class A Receivables or 12.0% for Class B Receivables. As of August 31, 2010, the three-month rolling average delinquent accounts rate was 0.77% for Class A Receivables and 4.82% for Class B Receivables and the three-month rolling average annualized default rate was 2.14% for Class A Receivables and 8.69% for Class B Receivables. As of August 31, 2010, there was an allowance for doubtful accounts of \$293,000 for customer accounts greater than 90 days past due.

During the second quarter of 2009 we were informed by Summit that the Trust II Credit Agreement we entered into with Trust II, Summit and various other parties had been reduced by \$20 million to \$30 million. Summit did not indicate the specific reasons for the reduction in the credit facility other than it was part of a negotiation with Fortress Corp. regarding a default on another Summit portfolio. This reduction had no impact

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

on the Company because during the third quarter of 2009, we ceased purchasing any new receivables under the facility and ceased originating new loans under the Trust II Credit Agreement and, as a result, the Company is no longer drawing additional funds under the Trust II Credit Agreement. Because we are no longer originating new loans under the Trust II Credit Agreement, FCC is no longer providing origination services to the Company. The origination services performed by FCC included loan documentation, collateral documentation where applicable, credit verification, and other required activities to secure loan approval per the Company's standards. FCC was paid a one-time fee of 2% of the original principal amount of loans originated for performing these services. FCC performs the monthly servicing activities, which include collections, reporting, lock



Table of Contents

box services, customer service, and other related services. FCC is paid 1.5%, per annum, of the outstanding principal balance for these services.

We received a notice of default dated December 2, 2009 from Fortress Corp. ( *Trust II Default Notice* ) stating that a servicer default had occurred and was continuing under the Trust II Credit Agreement, as a result of a material adverse effect with respect to the servicer. The Trust II Default Notice states that Fair, in its capacity as a sub-servicer for assets held by the SSPE Trust, has failed to perform its servicing duties with respect to that portion of the receivables portfolio owned by SSPE Trust for which Fair had been retained as a sub-servicer by the SSPE Trust. This failure, the Trust II Default Notice asserts, results from the ongoing federal investigation of Fair and Timothy Durham, and constitutes a material adverse effect with respect to the servicer and thus a breach of a covenant under the Trust II Credit Agreement. We also received a notice of default dated February 8, 2010 from Fortress Corp. ( *Second Trust II Default Notice* ) stating that an additional event of default had occurred and is continuing under the Trust II Credit Agreement as a result of the three-month rolling average Class A default ratio of the receivables exceeding 5.0% as of January 31, 2010. On February 26, 2010, the parties to the Trust II Credit Agreement entered into a waiver and release agreement (the *Fortress Waiver* ) whereby 1) each event of default declared in the Trust II Default Notice and the Second Trust II Default Notice was waived, 2) Trust II became the sole borrower under the Trust II Credit Agreement, 3) the outstanding borrowings attributable to SSPE Trust were paid in full, 4) SSPE Trust and their affiliates were released from all further obligations under the Trust II Credit Agreement, and 5) the SSPE Trust assets were removed as pledged collateral for the Trust II Credit Agreement. The Fortress Waiver also amended certain terms of the Trust II Credit Agreement including the elimination of Trust II's right to further borrowings and the requirement for Trust II to pay an unused commitment fee and the additional fee to the co-borrowers equal to an annual rate of 0.5%.

On May 13, 2010, the Company received a notice of default from Fortress Corp. stating that an event of default had occurred and was continuing under the Trust II Credit Agreement as a result of the three-month rolling average Class A default ratio of the receivables exceeding 5.0%. On May 19, 2010, the Company received an amended notice of default from Fortress Corp. (together with the original default notice, the *Third Trust II Default Notice* ) specifying that, as a consequence of the event of default, the Termination Date (as defined in the Trust II Credit Agreement) had occurred and the outstanding loan balance and other aggregate unpaids under the Trust II Credit Agreement will bear interest at the default rate. As a result of the default, pursuant to the Trust II Credit Agreement, the interest rate payable by Trust II has increased by an additional 2% per annum, and all collections by Trust II above amounts retained to pay interest, fees, principal amortizations, and other charges that are normally remitted to the Company, are instead being applied to outstanding principal under the Trust II Credit Agreement until the amount due has been reduced to zero. In addition, Fortress Corp. is entitled to foreclose on the assets of Trust II and sell them to satisfy amounts due it under the Trust II Credit Agreement. Only Trust II is liable for amounts due Fortress Corp. under the Trust II Credit Agreement. Thus, although the Company could lose some or all of its investment in Trust II, the Company will not be obligated to pay any amounts due Fortress Corp. under the Trust II Credit Agreement. All Trust II collections are being retained by Fortress Corp. and applied to pay interest and reduce indebtedness while the Company discusses amending the Trust II Credit Agreement, but Fortress Corp. has not sought to foreclose on the assets of Trust II. The Company is currently in discussions with Fortress Corp. to resolve all defaults under the Trust II Credit Agreement in conjunction with the matters set forth in the Trust I Default Notice and to address certain claims the Company may have against Fortress Corp. Those discussions are ongoing and the Company does not expect that Fortress Corp. will enforce any available foreclosure rights it may have on the assets of Trust II while these negotiations are proceeding. As of August 31, 2010, total borrowings under the Trust II Credit Agreement were \$4.0 million and were classified as a current liability as a result of the September 28, 2010 maturity of all borrowings under the Trust II Credit Agreement. The Company has engaged Raymond James & Associates, Inc. to assist the Company in these lender negotiations and to seek replacement financing for borrowings under the Trust II Credit Agreement.

We have the right to require the sellers to repurchase any accounts, for the original purchase price applicable to such account plus interest accrued thereon, that do not satisfy certain specified eligibility requirements set out in the Trust II Credit Agreement as of the purchase date. If it is discovered by a party that a receivable account was not an Eligible Receivable as of the purchase date, the seller is required to repurchase such receivable account. An account is not an Eligible Receivable if, as of the purchase date, such receivable account is, among other things, a defaulted receivable, a delinquent receivable, subject to litigation, dispute or rights of rescission, setoff or counterclaim, or is not subject to a duly recorded and perfected lien, as the terms are defined in the Trust II Credit Agreement. As discussed below in Part II, Item 1 Legal Proceedings Summit Litigation, the Company has filed a lawsuit against Summit and certain other parties alleging that certain receivables sold under the Trust II Purchase Agreement failed to meet certain agreed upon criteria, thus violating the Trust II Purchase Agreement and other related agreements between the parties. This litigation is currently pending and its outcome is uncertain.

CLST Asset III. The consideration paid by CLST Asset III in return for assets acquired under the Trust III Purchase Agreement was financed in part by the issuance of common stock and promissory notes to the sellers. We issued 2,496,077 shares of our common stock at a price of \$0.36 per share. In addition, we issued the sellers six promissory notes with an aggregate original stated principal amount of \$899,000 (the *Notes* ), of which two promissory notes in an aggregate original principal amount of

Table of Contents

\$709,000 were issued to Fair, two promissory notes in an aggregate original principal amount of \$163,000 were issued to Mr. Durham and two promissory notes in an aggregate original principal amount of \$27,000 were issued to Mr. Cochran. The Notes are full-recourse with respect to CLST Asset III and are unsecured. The three Notes relating to Portfolio A (the *Portfolio A Notes*) are payable in 11 quarterly installments, each consisting of equal principal payments, plus all interest accrued through such payment date at a rate of 4.0% plus the LIBOR Rate (as defined in the Portfolio A Notes). The three Notes relating to Portfolio B (the *Portfolio B Notes*) are payable in 21 quarterly installments, each consisting of equal principal payments, plus all interest accrued through such payment date at a rate of 4.0% plus the LIBOR Rate (as defined in the Portfolio B Notes).

We have the right to require the seller to repurchase any accounts, for the original purchase price applicable to such account, that do not satisfy certain specified eligibility requirements set out in the Trust III Purchase Agreement. If it is discovered by a party that a receivable account was not an Eligible Receivable as of February 13, 2009, the closing date of the acquisition, the seller is required to repurchase such receivable account. An account is not an Eligible Receivable if, as of February 13, 2009, such receivable account is a delinquent receivable, a defaulted receivable subject to litigation, dispute or rights of rescission, setoff or counterclaim, or is not subject to a duly recorded and perfected lien. For the three months ended August 31, 2010, there had not been a determination that any receivables failed to meet the eligibility requirements set out in the Trust III Purchase Agreement.

Additionally, the Trust III Purchase Agreement provides that each of the sellers jointly and severally guarantee to CLST Asset III, up to the aggregate stated principal amount of the Notes issued to such seller, that the outstanding receivable balance of each receivable as of the closing date will be collectible in full. For each receivable that becomes a defaulted receivable following the closing date, the sellers are obligated to pay to CLST Asset III an amount equal to the outstanding receivable balance of such receivable and CLST Asset III has the right to offset such amount against the amount due to the seller under the promissory notes issued to the sellers on the closing date. The aggregate amount of each seller's guarantee obligation is limited to the aggregate stated principal amount of the promissory note issued to such seller representing approximately 25% of the total purchase price of the portfolio of approximately \$3.6 million. Since the principal balance of the Notes declines over time as payments are made by the Company to the sellers, future defaulted receivables can be offset only against the then remaining balance of the Notes issued to the sellers. In February 2010, Fair commenced bankruptcy proceedings which may limit the Company's ability to continue to offset future receivable defaults against the Notes payable to Fair, but should not impact the Company's rights to continue to offset defaults of receivables against the other remaining Notes. Defaults of \$373,000 during the nine months ended August 31, 2010 were applied to the notes payable to the sellers and during the three months ended August 31, 2010, the notes payable to the sellers were completely offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted. However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be.

Asset Quality. Our delinquency rates reflect, among other factors, the credit risk of our receivables, the average age of our receivables, the success of our collection and recovery efforts, and general economic conditions. The average age of our receivables affects the stability of delinquency and loss rates of the portfolio. The composition of the portfolios is expected to change over time and the future performance of the receivables in the portfolios may be different from the historical performance. The table presented above in Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations also sets forth certain performance information, the aging and the aggregate delinquency and loss experience for the accounts in the portfolios as of and for the three months ended August 31, 2010. The global and economic crisis has had and could continue to have an adverse effect on the portfolio. The current deep economic recession and continued high unemployment have contributed to the significant increases in delinquencies for 2010 compared to historical performance. Our net losses and delinquencies may continue to correlate with declines in the general economy and increases in unemployment. Increases in net losses and delinquencies could continue, particularly if conditions in the general economy further deteriorate. We cannot assure you that the future delinquency and loss experience for the receivables will be similar to the historical experience.

An account is contractually delinquent if we do not receive the monthly payment by the specified due date. After accounts are delinquent for 120 days for CLST Asset I and 90 days for CLST Asset II and CLST Asset III, a provision (reserve) is made for the account balance. As of August 31, 2010, the allowance for doubtful accounts recorded for CLST Asset I and CLST Asset II is \$6.0 million and \$0.3 million,

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

respectively. The allowance for CLST Asset I and CLST Asset II is expensed in provision for doubtful accounts. CLST Asset III had a \$38,000 provision for doubtful accounts as of August 31, 2010 which represents the allowance for doubtful accounts in excess of the amounts that have been offset against the notes payable to the sellers per the Trust III Purchase Agreement.

For CLST Asset III, delinquent receivables are charged against the notes payable to the sellers per the terms of the Trust III Purchase Agreement. Defaults of \$373,000 during the nine months ended August 31, 2010 were applied to the notes payable to the sellers and during the three months ended August 31, 2010, the notes payable to the sellers were completely offset by defaulted receivables and the recoupment against Fair for payments of approximately \$137,000 it has received on our behalf and not remitted.

Table of Contents

However, there can be no assurance that Fair will not challenge our recoupment right, or what the ultimate outcome of any such challenge might be.

*Contractual Obligations.* Included in accounts payable at August 31, 2010, is approximately \$14.2 million associated with liabilities which accrued in periods 2002 and earlier, and which has been in dispute since 2001. The Company now believes that the statute of limitations on this trade payable may have expired. The Company is reviewing these liabilities, and considering appropriate steps to resolve them. In addition, the Company contacted the vendor in question several times during the second quarter of 2009 regarding this matter with no results. The Company expects that the liabilities may be resolved at less than the book value thereof, but can not provide assurances as to the amount or timing of any adjustments. In the event that the Company is able to settle the dispute with no payment, the settlement would result in \$14.2 million of income to the Company for federal income tax purposes, and therefore the deferred income tax asset will be realized. If the Company is able to settle the dispute for any amount between \$1 and \$14.2 million, the deferred tax asset will be adjusted accordingly.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

This information has been omitted as our Company qualifies as a smaller reporting company.

**Item 4. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and include controls and procedures designed to ensure that information we are required to disclose in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our management, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15(d)-15(e) promulgated under the Exchange Act, as of the end of the period covered by this Form 10-Q/A. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this Form 10-Q/A, our disclosure controls and procedures are not effective because (1) the Company has not required SAS 70 reports and is not receiving timely audited financial statements from the servicers of the Company's consumer receivable portfolios, and (2) the Company lacks adequate supervision, segregation of duties, and technical accounting expertise necessary for an effective system of internal control and timely financial reporting. In an effort to mitigate these material weaknesses, the Company's management has conducted tests to determine the accuracy and completeness of the Company's consumer receivable portfolios. The Company also receives detailed reports at least monthly from the companies servicing these receivable portfolios. The Chief Executive Officer, Chief Financial Officer and Senior Accountant all review these reports for any unusual items and meet with representatives of the servicers to review the status of the portfolios and discuss any unusual items. All of our financial reporting is carried out by our Chief Financial Officer and Senior Accountant with the assistance of third parties from time to time. The lack of accounting staff and dependence on third party assistance results in a lack of segregation of duties and at times a lack of sufficient accounting technical expertise which could impact our financial reporting function. In order to mitigate this control deficiency to the fullest extent possible, all financial reports are reviewed by the Chief Executive Officer, Chief Financial Officer as well as the Board for reasonableness. All unexpected results are investigated. At any time, if it appears that any control can be implemented to continue to mitigate such control deficiencies in a cost effective manner, the Company will attempt to implement the control.

**Changes in Internal Control over Financial Reporting**

The material weaknesses reported above continue to exist. There have been no changes in our internal control over financial reporting during the three months ended August 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

**Introduction**

The Company has expended a significant amount of management time and resources in connection with the Federal Court Action and the State Court Action (as defined below). The Company has had settlement discussions with Red Oak from time to time in the past regarding the Federal Court Action, but those discussions have not been successful. The Company may have further

Table of Contents

settlement discussions with Red Oak in the future. No assurance can be given that any settlement agreement could be reached if the Company undertakes further discussions or, if a settlement agreement is entered into, that the terms of any settlement would not have a material adverse effect on the Company, its financial position, or its results of operations.

On June 18, 2010, the State Court Action was dismissed, as discussed below. However, on June 23, 2010 Ron Phillips and Scott Moorehead filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 298th District Court of Dallas County, Texas. No assurance can be given of the effect that the newly filed state court lawsuit will have on the Company, its financial position or its results of operations.

**Red Oak Federal Court Action**

In December 2008, David Sandberg of the Red Oak Group placed a telephone call to Robert Kaiser expressing interest in the Red Oak Group making a minority investment in the Company and obtaining control of the Company. Our Board responded by suggesting that the Red Oak Group and the Company discuss the Red Oak Group's desire to make a minority investment and obtain control after the Company filed its Annual Report on Form 10-K for the fiscal year ended November 30, 2008 with the SEC and made its results of operations available to the Company's stockholders.

On January 15, 2009, the Red Oak Group acquired 5,000 shares of our common stock in secondary market and privately negotiated transactions. On or about January 30, 2009, the Red Oak Group requested that the Company provide a stockholder list and security position listings, which it said it would use to make a tender offer. On February 3, 2009, the Red Oak Group announced its plan to commence a tender offer to acquire up to 70% of our outstanding shares of common stock at \$0.25 per share. On February 5, 2009, we adopted the Rights Plan which became effective on February 16, 2009. Stating the Company's Rights Plan as its reason, the Red Oak Group announced on February 9, 2009 that it had abandoned its intention to make a tender offer. Nevertheless, the Red Oak Group continued through February 13, 2009 to acquire shares of our common stock in the secondary market and privately negotiated transactions resulting in its beneficial ownership of 4,561,554 shares of our common stock (according to the Red Oak Group's Schedule 13D filed with the SEC on February 18, 2009), representing approximately 19.05% of our outstanding common stock as of the record date. The Red Oak Group made its purchases of our common stock in open-market and privately negotiated transactions, not by means of tender offer materials filed with the SEC.

On February 13, 2009, we filed a lawsuit in the United States District Court for the Northern District of Texas against Red Oak Fund, L.P., Red Oak Partners, LLC, and David Sandberg (the *Federal Court Action*). Our Original Complaint and Application for Injunctive Relief alleges that Red Oak engaged in numerous violations of federal securities laws in making purchases of our common stock and sought to enjoin any future unlawful purchases of our stock by them, their agents, and persons or entities acting in concert with them. We believe Red Oak violated federal securities laws as follows:

- (i) violating Rule 14(e)-5 of the Exchange Act by not truly abandoning its tender offer and instead directly or indirectly purchasing or arranging to purchase shares not in connection with its tender offer and without complying with the procedural, disclosure and anti-fraud requirements applicable to tender offers regulated under Section 14 of the Exchange Act;

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

(ii) violating Exchange Act Rule 14d-5(f) by failing to return the Company's stockholder list, which we provided to Red Oak upon its request, and by using such list for a purpose other than in connection with the dissemination of tender offer materials in connection with its tender offer;

(iii) violating Exchange Act Rule 14(d)-10 by purchasing shares pursuant to its tender offer at varying prices rather than paying consideration for securities tendered in the tender offer at the highest consideration paid to any stockholder for securities tendered; and

(iv) violating Section 13(d) of the Exchange Act by not timely filing a Schedule 13D and disclosing the information required therein.

On March 13, 2009, we announced that we would hold our Annual Meeting of Stockholders on May 22, 2009 in Dallas, Texas, and that the close of business on April 2, 2009 would be the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting or any adjournments or postponements thereof.

On March 18, 2009, the Red Oak Group sent a letter to us demanding to inspect and copy certain of our books and records. We have taken the position that the Red Oak Group did not comply with state law requirements applicable to stockholders seeking such information.



Table of Contents

On March 19, 2009, the Red Oak Group sent a letter to us stating its intention to put forth several precatory proposals including stockholder votes for: approval to proceed with the 2007 stockholder-approved plan of dissolution; approval of the November 10, 2008 transaction whereby CLST Asset I, a wholly owned subsidiary of Financo, entered into a purchase agreement to acquire all of the outstanding equity interests of Trust I from a third party for approximately \$41.0 million; approval of the 2008 Plan pursuant to which the Board approved the new issuance to themselves of up to 20 million shares of common stock, or just over 97% of the common stock outstanding at the time this plan was approved; approval of the December 12, 2008 transaction whereby Trust II, a newly formed trust wholly owned by CLST Asset II, a wholly owned subsidiary of Financo entered into a purchase agreement, effective as of December 10, 2008, to acquire (i) on or before February 28, 2009 receivables of at least \$2 million, subject to certain limitations and (ii) from time to time certain other receivables, installment sales contracts, and related assets; and approval of the February 13, 2009 transaction whereby CLST Asset III, a newly formed, wholly owned subsidiary of Financo, which is one of CLST's direct, wholly owned subsidiaries, purchased certain receivables, installment sales contracts, and related assets owned by Fair, which is partly owned by Timothy S. Durham, an officer and director of CLST. On the same day, the Red Oak Group sent a letter to us stating its intention to nominate a slate of directors to our Board.

On April 6, 2009, we notified the Red Oak Group that our Board rejected the Red Oak Group's nominations for Class I and Class II seats, as the nominations were not in accordance with our certificate of incorporation. In addition, we also rejected the Red Oak Group's proposals because they were not proper in form or substance under federal and state law to come before an Annual Meeting. We offered to discuss the Red Oak Group's concerns, director nominations, and stockholder proposals provided that (1) the Red Oak Group and the Company enter into a confidentiality and standstill agreement, (2) the Red Oak Group appropriately make publicly available disclosures regarding its rapid accumulation of the Company's shares and its intentions to acquire control of the Company that are required by the federal securities laws, including in a Report on Schedule 13D, and (3) the Red Oak Group not vote the shares that the Company believes it to have acquired in violation of applicable law, including the tender offer rules and other rules regulating such accumulation of shares under the federal securities laws, at the Annual Meeting.

Also on April 6, 2009, we filed our First Amended Complaint and Application for Injunctive Relief in the Federal Court Action adding Red Oak's affiliates (Pinnacle Partners, LLC; Pinnacle Fund, LLLP; and Bear Market Opportunity Fund, L.P.) as defendants, alleging the same and other violations of federal securities laws, including:

- (i) filing a materially false and misleading Schedule 13D and failing to amend the same after delivering to the Company a Notice of Director Nominations and proposal for business at the Annual Meeting;
- (ii) violating Section 14(d) of the Exchange Act by engaging in fraudulent, deceptive and manipulative acts in connection with its tender offer by failing to abide by Section 14(d)'s timing requirements and by failing to make required filings with the SEC; and
- (iii) that any attempt to solicit proxies from our stockholders with respect to director nominations or notice of business would be misleading in light of the defendants' illegal activities in accumulating Company stock.

Through this action, we seek to obtain various declaratory judgments that the defendants have failed to comply with federal securities laws and to enjoin the defendants from, among other things, further violating federal securities laws and from voting any and all shares or proxies acquired in violation of such laws.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

Also on April 6, 2009, because, among other reasons, we did not expect the litigation, which bears directly upon our Annual Meeting of stockholders, to be resolved for some months, our Board postponed the Annual Meeting of stockholders previously scheduled for May 22, 2009 until September 25, 2009.

On April 15, 2009, the Red Oak Group submitted another letter to the Company, providing additional information regarding the stockholder proposals it intends to bring before the Annual Meeting and revising those proposals to: request the Board to complete the dissolution approved at the stockholder meeting held in 2007; advise the Board that the stockholders do not approve of the transaction purportedly entered into as of November 10, 2008 whereby CLST Asset I, a wholly owned indirect subsidiary of the Company, entered into a purchase agreement to acquire the outstanding equity interest in Trust I and request the directors to take any available and appropriate actions; disapprove the 2008 Plan adopted by the Board and request the Board not to issue any additional share grants or option grants under such plan and request that the directors rescind their approval of such plan; advise the Board that the stockholders disapprove of the transaction purportedly entered into as of December 12, 2008 pursuant to which CLST Asset II, an indirect wholly owned subsidiary of the Company, entered into a purchase agreement to acquire certain receivables on or before February 28, 2009 and request the directors to take any available and appropriate actions; and advise the Board that the stockholders disapprove of the transaction purportedly entered into as of February 13, 2009 whereby CLST Asset III, an indirect wholly owned subsidiary of the Company purchased certain receivables, installment contracts and related assets owned by Fair and request the directors to take any available and appropriate actions.

Table of Contents

On July 24, 2009, we filed our Brief in Support of Application for Preliminary Injunction. The Red Oak Group filed its Opposition on August 7, 2009, and we filed our Reply Brief in Support on August 14, 2009. On October 14, 2009, the court denied the Company's Application for Preliminary Injunction.

On December 30, 2009, the Company voluntarily filed a Motion to Dismiss the Federal Court Action ( *Federal Motion to Dismiss* ). As an exercise of its business judgment, the Board decided not to pursue CLST's claims against the Red Oak Group beyond the preliminary injunction stage.

On January 20, 2010, the Red Oak Group filed its Combined Motion for Leave to Amend, to Join Third Parties, to Vacate Scheduling Order and to Continue the Trial Date ( *Motion for Leave* ) and its Motion for Attorneys' Fees under Rule 11 of the Federal Rules of Civil Procedure ( *Rule 11 Motion* ). By its Motion for Leave, Red Oak sought to join Messrs. Durham, Kaiser, and Tornek as defendants and to add claims against them and CLST respectively for alleged violations of Sections 13(d), 14(a), and 10(b) of the Exchange Act and certain rules promulgated thereunder. By its Rule 11 Motion, the Red Oak Group sought to recover all of its attorneys' fees and costs in defending this action from CLST based on the legal contention that injunctive relief is not available for a violation of Section 13(d) of the Exchange Act.

On March 2, 2010, the court denied the Federal Motion to Dismiss and granted the Red Oak Group's Motion for Leave. The court also denied the Red Oak Group's Rule 11 Motion. On March 17, 2010, the Red Oak Group filed its Counterclaims and Third-Party Complaint against the Company, alleging violations of Sections 13(d), 14(a) and 10(b) of the Exchange Act.

On April 21, 2010, Red Oak filed its Motion to Expedite Discovery and Briefing Schedule ( *Motion for Expedited Discovery* ). The same day, Red Oak filed its Application for a Preliminary Injunction to Issue Before June 6, 2010 ( *Application for Preliminary Injunction* ). Red Oak's Application for Preliminary Injunction sought a preliminary injunction compelling Messrs. Kaiser, Durham, and Tornek to make corrective disclosures to comply with alleged violations of Section 13(d) of the Exchange Act. Red Oak's Motion for Expedited Discovery sought discovery in support of its Application for Preliminary Injunction. On May 4, 2010, the court denied Red Oak's Motion for Expedited Discovery and further denied Red Oak's Application for Preliminary Injunction.

On May 17, 2010, the Company filed its Motion to Dismiss Red Oak's Counterclaims and Brief in Support ( *Motion to Dismiss Red Oak's Counterclaims* ) seeking to dismiss all alleged violations of Sections 13(d), 14(a), and 10(b) of the Exchange Act. The same day, Messrs. Kaiser, Durham, and Tornek individually filed respective motions to dismiss Red Oak's third-party claims. On June 21, 2010, Red Oak filed its consolidated Opposition to Motions to Dismiss. Therein, Red Oak states that its disclosure-based Section 13(d) and 14(a) claims are moot and that it intends to voluntarily dismiss those claims. On July 21, 2010, Red Oak filed a Notice of Dismissal, thereby dismissing its disclosure-based Section 13(d) and 14(a) claims. On August 20, 2010, the court denied CLST's Motion to Dismiss Red Oak's Counterclaims and the respective motions to dismiss filed by Messrs. Kaiser and Durham; the court, however, granted Mr. Tornek's motion to dismiss. The Federal Court Action remains pending.

**Red Oak State Court Action**

On March 2, 2009, certain members of the Red Oak Group (namely, Red Oak Partners, LLC; Pinnacle Fund, LLP; and Bear Market Opportunity Fund, L.P.) and Jeffrey S. Jones ( *Jones* ) (the Red Oak Group and Jones may be collectively referred to below as *Plaintiffs* ) filed a derivative

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 134th District Court of Dallas County, Texas (the *State Court Action* ). The petition alleges that Messrs. Kaiser, Durham, and Tornek entered into self-dealing transactions at the expense of the Company and its stockholders and violated their fiduciary duties of loyalty, independence, due care, good faith, and fair dealing. The petition asks the court to order, among other things, a rescission of the alleged self-interested transactions by Messrs. Kaiser, Durham, and Tornek; an award of compensatory and punitive damages; the removal of Messrs. Kaiser, Durham, and Tornek from the Board; and that the Company hold an Annual Meeting of stockholders, or that the Company appoint a conservator to oversee and implement the dissolution plan approved by stockholders in 2007.

On March 13, 2009, we announced that we would hold our Annual Meeting of Stockholders on May 22, 2009 in Dallas, Texas, and that the close of business on April 2, 2009 would be the record date for the determination of stockholders entitled to receive notice of, and to vote at, the Annual Meeting or any adjournments or postponements thereof.

On March 18, 2009, the Red Oak Group sent a letter to us demanding to inspect and copy certain of our books and records. We took the position that the Red Oak Group did not comply with state law requirements applicable to stockholders seeking such information.

Table of Contents

On March 19, 2009, the Red Oak Group sent a letter to us stating its intention to put forth several precatory proposals including stockholder votes for: approval to proceed with the 2007 stockholder-approved plan of dissolution; approval of the November 10, 2008 transaction whereby CLST Asset I, a wholly owned subsidiary of Financo, entered into a purchase agreement to acquire all of the outstanding equity interests of Trust I from a third party for approximately \$41.0 million; approval of the 2008 Plan pursuant to which the Board approved the new issuance to themselves of up to 20 million shares of common stock, or just over 97% of the common stock outstanding at the time this plan was approved; approval of the December 12, 2008 transaction whereby Trust II, a newly formed trust wholly owned by CLST Asset II, a wholly owned subsidiary of Financo entered into a purchase agreement, effective as of December 10, 2008, to acquire (i) on or before February 28, 2009 receivables of at least \$2 million, subject to certain limitations and (ii) from time to time certain other receivables, installment sales contracts and related assets; and approval of the February 13, 2009 transaction whereby CLST Asset III, a newly formed, wholly owned subsidiary of Financo, which is one of CLST's direct, wholly owned subsidiaries, purchased certain receivables, installment sales contracts and related assets owned by Fair, which is partly owned by Timothy S. Durham, an officer and director of CLST. On the same day, the Red Oak Group sent a letter to us stating its intention to nominate a slate of directors to our Board.

On April 6, 2009, we notified the Red Oak Group that our Board rejected the Red Oak Group's nominations for Class I and Class II seats, as the nominations were not in accordance with our certificate of incorporation. In addition, we also rejected the Red Oak Group's proposals because they were not proper in form or substance under federal and state law to come before an Annual Meeting. We offered to discuss the Red Oak Group's concerns, director nominations, and stockholder proposals provided that (1) the Red Oak Group and the Company enter into a confidentiality and standstill agreement, (2) the Red Oak Group appropriately make publicly available disclosures regarding its rapid accumulation of the Company's shares and its intentions to acquire control of the Company that are required by the federal securities laws, including in a Report on Schedule 13D, and (3) the Red Oak Group not vote the shares that the Company believes it to have acquired in violation of applicable law, including the tender offer rules and other rules regulating such accumulation of shares under the federal securities laws, at the Annual Meeting.

Also on April 6, 2009, because, among other reasons, we did not expect the litigation, which bears directly upon our Annual Meeting of stockholders, to be resolved for some months, our Board postponed the Annual Meeting of stockholders previously scheduled for May 22, 2009 until September 25, 2009.

On April 15, 2009, the Red Oak Group submitted another letter to the Company, providing additional information regarding the stockholder proposals it intends to bring before the Annual Meeting and revising those proposals to: request the Board to complete the dissolution approved at the stockholder meeting held in 2007; advise the Board that the stockholders do not approve of the transaction purportedly entered into as of November 10, 2008 whereby CLST Asset I, a wholly owned indirect subsidiary of the Company, entered into a purchase agreement to acquire the outstanding equity interest in Trust I and request the directors to take any available and appropriate actions; disapprove the 2008 Plan adopted by the Board and request the Board not to issue any additional share grants or option grants under such plan and request that the directors rescind their approval of such plan; advise the Board that the stockholders disapprove of the transaction purportedly entered into as of December 12, 2008 pursuant to which CLST Asset II, an indirect wholly owned subsidiary of the Company, entered into a purchase agreement to acquire certain receivables on or before February 28, 2009 and request the directors to take any available and appropriate actions; and advise the Board that the stockholders disapprove of the transaction purportedly entered into as of February 13, 2009 whereby CLST Asset III, an indirect wholly owned subsidiary of the Company purchased certain receivables, installment contracts and related assets owned by Fair and request the directors to take any available and appropriate actions.

On April 30, 2009, the Red Oak Group and Jones amended their petition in the State Court Action. In addition to the relief already requested, the petition sought to compel the Company to hold its 2008 and 2009 annual stockholders' meetings within sixty days; to enjoin Messrs. Kaiser, Durham, and Tornek from any interference or hindrance of such meetings or the election of directors; to enjoin Messrs. Kaiser, Durham, and Tornek from voting any shares of stock acquired in the alleged self-interested transactions; and to appoint a special master. On June 3, 2009 and again on June 12, 2009, pursuant to court order, the Red Oak Group and Jones amended their petition to, among other things, remove Bear Market Opportunity Fund, L.P. as a plaintiff and add Red Oak Fund, L.P. as a plaintiff.

## Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

On May 5, 2009, the Red Oak Group and Jones filed a motion seeking to compel the Company to hold its 2008 and 2009 stockholders' meetings on June 30, 2009 and to appoint a special master and requested an expedited hearing on both. Hearings were held on May 8, 2009 and May 29, 2009, but no ruling was reached.

On August 14, 2009, our Board postponed the Annual Meeting of stockholders from September 25, 2009 to October 27, 2009.

On August 24, 2009, the Red Oak Group resubmitted its director nomination letter and its letter stating its intention to put forth the stockholder proposals, as mentioned in the March 19, 2009 and April 15, 2009 letters.

Table of Contents

On August 25, 2009, the court set an evidentiary hearing on the Plaintiffs' Application for Temporary Injunction, which had yet to be filed, for October 7 and 8, 2009. Plaintiffs' request for injunctive relief concerned Messrs. Kaiser, Durham, and Tornek voting any shares of stock acquired in the alleged self-interested transactions.

On August 28, 2009, the parties executed a Stipulation Regarding the Company's Annual Meeting of Stockholders ( *Stipulation* ). The court approved the Stipulation the same day and entered an Order identical to the Stipulation's terms. Pursuant to the Stipulation, absent a determination by the court of good cause shown, the Company must hold its annual stockholders' meeting for the election of one Class I director and one Class II director and consideration of any properly submitted proposals that are proper subjects for consideration at an annual meeting on October 27, 2009, with a record date for that meeting of September 25, 2009. Good cause for delaying the Annual Meeting beyond October 27, 2009, and correspondingly amending the September 25, 2009 record date, includes among other things, situations where reasonable delay is necessary: (1) for the Board to avoid breaching any of their fiduciary duties to the Company or the Company's stockholders; (2) to assure compliance with the Company's certificate of incorporation and bylaws; (3) for the Company or the Board to comply with state or federal law; or (4) to assure compliance with any order of any court or regulatory authority having jurisdiction over the Company or members of its Board.

We received a letter dated September 22, 2009 from the Red Oak Group seeking, pursuant to Section 220 of the Delaware General Corporation Law, to inspect the books and records of the Company, including among other things a stockholder list as of the record date. The letter states that the purpose of such request is to enable the Red Oak Group to solicit proxies to elect directors at the 2009 Annual Meeting and to communicate with stockholders. Our counsel responded by letter dated September 30, 2009 that the Company was aware of its obligations under Section 220 of the Delaware General Corporation Law but believed that the demand letter did not comply with the inspection requirements under Section 220. We received another letter dated September 29, 2009 from the Red Oak Group pursuant to Section 220 of the Delaware General Corporation Law in which the Red Oak Group requests to inspect the books and records of the Company pertaining to, among other things, all analyses performed with respect to our net operating losses and a list of all business ventures and dealings Messrs. Tornek and Durham have evaluated or commenced in the past ten years and a list of all investments they currently share. Our counsel responded by letter dated October 6, 2009 that (i) the commencement of the Red Oak Group's derivative action bars it from using a Section 220 demand as a substitute for discovery permissible in litigation; (ii) the stated purposes of the demand letter do not constitute proper purposes under Section 220; and (iii) the scope of information requested in the demand letter is overly broad and not limited to books and records that are essential and sufficient to accomplish the Red Oak Group's stated purposes.

On October 9, 2009, the court denied Plaintiffs' application for injunctive relief, which sought to enjoin Messrs. Kaiser, Durham, and Tornek from voting certain shares at the CLST annual stockholders' meeting. Further, the court granted Defendants' plea to the jurisdiction, granted Defendants' motion to disqualify Plaintiffs, and dismissed Plaintiffs' derivative claims. Beyond that, the court granted Defendants' amended motion to stay, thereby staying all remaining direct claims asserted by Plaintiffs. Defendants' motion to disqualify Plaintiffs was based on Plaintiffs' lack of adequacy to pursue derivative claims on the following grounds: (1) that Red Oak improperly brought derivative claims to advance its own personal interests; (2) that Red Oak had engaged in illegal conduct by violating federal securities laws; and (3) that Jones was only a tag-along plaintiff and therefore suffered the same adequacy problems as Red Oak, the driving force behind the State Court Action. The court reached each of these rulings after the two-day evidentiary hearing.

On October 15, 2009, we applied to the court, on an emergency basis, for an order to: (1) reopen this case for the limited purpose of modifying the court's Order Regarding Annual Meeting of Stockholders entered on August 28, 2009 (the *Annual Meeting Order* ); (2) modify its Annual Meeting Order to prevent CLST from alternatively being in violation of (a) federal securities law, Delaware statutory law, and its Bylaws or (b) the Annual Meeting Order; (3) nullify the current September 25, 2009 record date; and (4) grant an emergency hearing as soon as possible. A hearing was held on CLST's emergency motion on October 16, 2009. The court continued the hearing until a time agreeable to the parties and the court on or before October 26, 2009.

Edgar Filing: CLST HOLDINGS, INC. - Form 10-Q/A

On October 29, 2009, Plaintiffs filed their Motion and Memorandum to Reopen Case And To Reconsider ( *Motion to Reconsider* ) concerning the court's Order of October 9, 2009, which granted Defendants' Plea to the Jurisdiction and Motion to Disqualify Plaintiffs and dismissed Plaintiffs' derivative claims. On December 10, 2009, Plaintiffs filed their Motion and Memorandum to Reopen Case and Compel Annual Stockholders Meeting ( *Motion to Compel* ).

On November 12, 2009, the parties executed a Second Stipulation and Order Setting and Regarding an Annual Meeting of Stockholders of the Company (the *Second Stipulation* ). The court approved the Second Stipulation on November 13, 2009 and entered an Order identical to the Second Stipulation's terms. The Second Stipulation provides that the Company must hold its annual stockholders' meeting on December 15, 2009 and that the record date for that meeting must be set as October 30, 2009.



Table of Contents

At the December 15, 2009 hearing on Plaintiffs' Motion to Reconsider, Plaintiffs' counsel stated on the record that Plaintiffs' Motion to Compel had not been properly noticed and therefore was not before the court. The court denied Plaintiffs' Motion to Reconsider on December 21, 2009.

On January 15, 2010, Plaintiffs filed their Motion for Summary Relief, Summary Judgment, and Application for Injunctive Relief to Compel the Company's Annual Stockholders Meeting ( *Motion for Summary Relief* ). By their Motion for Summary Relief, Plaintiffs sought for the Company to hold its annual stockholders meetings for 2008, 2009, and 2010 on March 25, 2010. On February 15, 2010, the court heard Plaintiffs' Motion for Summary Relief and, in part, granted the relief requested. Specifically, the court ordered, pursuant to its Order and Interlocutory Partial Summary Judgment (the *Second Annual Meeting Order* ) as follows: (1) Absent a determination by the court for good cause shown, the Company shall hold its annual stockholders meeting on March 23, 2010 (the *Annual Meeting* ); the Annual Meeting satisfies the Company's requirement to hold its 2008 and 2009 annual stockholders meetings; the record date for the Annual Meeting shall be March 8, 2010; and the Company shall provide notice in accordance with applicable Delaware law to all CLST stockholders on or before March 12, 2010 for the Annual Meeting. By the same order, the court also appointed IVS Associates, Inc. to be the independent inspector of elections to oversee the voting process of the Annual Meeting, tabulate proxies, and certify the election results. By separate order dated February 15, 2010, and upon its own motion, the court ordered that the State Court Action be reopened and reinstated on a two-week trial docket beginning June 1, 2010.

On February 18, 2010, the Red Oak Group filed its Application for TRO and sought to prevent the Company from filing a certificate of dissolution with the Delaware Secretary of State on February 26, 2010, as the Company had disclosed in its Form 8-K filed on February 9, 2010. The hearing on the Application for TRO was held on February 23, 2010. On February 24, 2010, the court granted Red Oak's Application for TRO and, pursuant to the TRO, ordered, among other things, that the defendants (namely, CLST Holdings, Inc., Robert Kaiser, Timothy Durham, and David Tornek) and their agents be restrained from filing the certificate of dissolution for the Company on or before midnight on Wednesday, March 10, 2010, or until further order of the court.

On March 2, 2010, the court signed the order upon the Stipulation and Agreed Temporary Injunction with Red Oak (the *Dissolution Stipulation* ), which provides, among other things, that, on or before March 5, 2010, the Company will send notice of its intent to file a certificate of dissolution with the Delaware Secretary of State on March 26, 2010, and that the notice shall indicate that the certificate of dissolution will not be effective until June 24, 2010.

After the Second Annual Meeting Order issued, the Company filed an emergency motion for temporary relief ( *Motion for Relief* ) requesting that the Fifth District Court of Appeals of Texas at Dallas (the *Court of Appeals* ) void the Second Annual Meeting Order. On March 3, 2010, the Court of Appeals issued a memorandum opinion in which the Court of Appeals granted the Company's Motion for Relief and voided the Second Annual Meeting Order. The Court of Appeals' judgment taxes all costs of the appeal against the Red Oak Group. On March 4, 2010, the trial court entered its Order dissolving the Second Annual Meeting Order.

Pursuant to the Dissolution Stipulation and in accordance with its plan of dissolution, on March 26, 2010 the Company filed a certificate of dissolution with the Delaware Secretary of State which became effective on June 24, 2010. Accordingly, immediately after the close of business on June 24, 2010, the Company closed its stock transfer books and discontinued recording transfers of shares of its common stock. Since June 24, 2010, there has only been limited trading activity among street name holders on the OTCQB of beneficial interests held by the Company's stockholders at the time of dissolution.

On March 26, 2010, the Red Oak Group filed its Motion to Dismiss for Lack of Jurisdiction, for Leave to Amend Petition, Attorneys' Fees, and for a Final Order Granting Permanent Injunctive Relief ( *State Motion to Dismiss* ). By its State Motion to Dismiss, the Red Oak Group seeks an order that, among other things, sets the Company's annual stockholders meetings for 2008 and 2009 fifty (50) days after the issuance of such an

order and sets the record date thirty (30) days before such annual meeting. Following an April 7, 2010 hearing before the court on the Red Oak Group's State Motion to Dismiss, the Court set the case for trial on May 24, 2010. On May 19, 2010, the Red Oak Group filed its Unopposed Motion for Voluntary Dismissal. On June 18, 2010, the court signed the Order of Dismissal.

**Phillips/Moorehead State Court Action**

On June 23, 2010, Company stockholders Ron Phillips and Scott Moorehead, putative plaintiffs, filed a derivative lawsuit against Robert A. Kaiser, Timothy S. Durham, and David Tornek in the 298th District Court of Dallas County, Texas. The petition alleges that Messrs. Kaiser, Durham, and Tornek entered into self-dealing transactions at the expense of the Company and its stockholders and violated their fiduciary duties of loyalty, independence, due care, good faith, and fair dealing. Among other things, the petition also seeks the rescission of the Company's Long Term Incentive Plan and the Rights Plan, an award of compensatory and punitive damages, and the appointment of a trustee or conservator to oversee the windup and dissolution of the Company. No assurance can be given of the effect that the newly filed state court lawsuit will have on the Company, its financial position or its results of operations.

Table of Contents

**Summit Litigation**

On August 31, 2010, CLST Holdings, Inc., CLST Financo, Inc., and CLST Asset II, LLC (the *CLST Parties*) filed a lawsuit in the 101st Judicial District Court of Dallas County, Texas against Summit Alternative Investments, LLC, Summit Consumer Receivables Fund, L.P., SSPE, LLC, SSPE Investment Trust I, Eric J. Gangloff, and Wayne M. Crane (the *Summit Parties*). The lawsuit arises from the Company's purchase of receivables, installment sales contracts, and related assets under the Trust II Purchase Agreement. The CLST Parties allege that certain receivables sold by the Summit Parties failed to meet certain agreed upon criteria, thus violating the Trust II Purchase Agreement and other related agreements between the parties. The CLST Parties have asserted claims against the Summit Parties for common law fraud, negligent misrepresentation, violations of the Securities Act, violations of the Texas Securities Act, and breach of contract. The CLST Parties have demanded a jury trial.

**Item 1A. Risk Factors**

For risk factors, please refer to Item 1A, Risk Factors, of our Annual Report on Form 10-K for the fiscal year ended November 30, 2009.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. [REMOVED AND RESERVED]**

**Item 5. Other Information**

None.



Table of Contents

**Item 6. Exhibits**

| <b>Exhibit No.</b> | <b>Description</b>   | <b>Previously filed as an Exhibit and Incorporated by Reference From</b>  |
|--------------------|--|---|
| 3.1                | Amended and Restated Certificate of Incorporation of CellStar Corporation (the Certificate of Incorporation )  | Previously filed as an exhibit to our company's Quarterly Report on Form 10-Q for the quarter ended August 31, 1995, and incorporated herein by reference.                  |
| 3.2                | Certificate of Amendment to Certificate of Incorporation.  | Previously filed as an exhibit to our company's Quarterly Report on Form 10-Q for the quarter ended May 31, 1998, and incorporated herein by reference.                     |
| 3.3                | Certificate of Amendment to Certificate of Incorporation dated as of February 20, 2002.  | Previously filed as an exhibit to our company's Annual Report Form on Form 10-K for the fiscal year ended November 30, 2002 and incorporated herein by reference.           |
| 3.4                | Certificate of Amendment to the Amended and Restated Certificate of Incorporation dated as of March 30, 2007.  | Previously filed as an exhibit to our company's Quarterly Report on Form 10-Q for the quarter ended May 31, 2007, and incorporated herein by reference.                     |
| 3.5                | Amended and Restated Bylaws of CellStar Corporation, effective as of May 1, 2004.  | Previously filed as an exhibit to our Quarterly Report on Form 10-Q for the quarter ended May 31, 2004, and incorporated herein by reference.                               |
| 3.6                | Certificate of Dissolution of CLST Holdings, Inc., effective as of June 24, 2010.  | Previously filed as an exhibit to a Current Report on Form 8-K filed with the Securities and Exchange Commission on March 26, 2010, and incorporated herein by reference.   |
| 4.1                | Rights Agreement, dated as of February 13, 2009, by and between CLST Holdings, Inc. and Mellon Investor Services LLC, as rights agent.   | Previously filed as an exhibit to a Form 8-A filed with the Securities and Exchange Commission on February 13, 2009, and incorporated herein by reference.                  |
| 4.2                | Certificate of Designation of Series B Junior Preferred Stock of CLST Holdings, Inc., dated as of February 5, 2009.  | Previously filed as an exhibit to a Current Report on Form 8-K filed with the Securities and Exchange Commission on February 6, 2009, and incorporated herein by reference. |
| 31.1               | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.   | Filed herewith.   |
| 31.2               | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended.   | Filed herewith.   |
| 32.1               | Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350. | Filed herewith.   |

Table of Contents

**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CLST HOLDINGS, INC.

By:                   /s/ Robert A. Kaiser  
                          Robert A. Kaiser  
                          Chief Executive Officer and President

By:                   /s/ Jerome L. Trojan III  
                          Jerome L. Trojan III  
                          Chief Financial Officer, Vice President and Treasurer

October 15, 2010